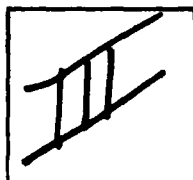


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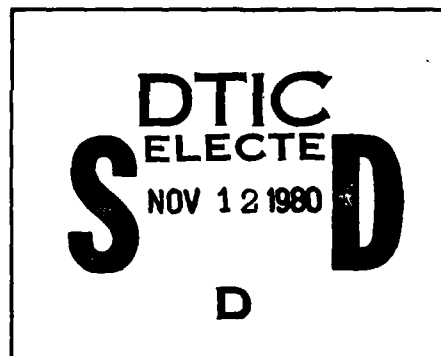
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THE IMPACT OF BALANCE OF PAYMENT  
CONSIDERATIONS UPON LOGISTICAL  
SUPPORT OF U.S. ARMED FORCES  
EUROPE 1960-1974.

A thesis presented to the Faculty of the U.S. Army  
Command and General Staff College in partial  
fulfillment of the requirements of the  
degree

MASTER OF MILITARY ART AND SCIENCE

by

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## ABSTRACT

During 1960, the Eisenhower Administration determined that the consistent deficit position of the United States balance of payment account threatened the strength of our currency and the stability of the international and domestic sectors of the economy. Since Department of Defense overseas expenditures contributed to the deficit, actions were initiated to reduce offshore military spending. During the fifteen years that have intervened since 1960, a structure of policies and procedures have been established to minimize overseas expenditures. For example, with some exceptions, overseas commands have been directed to return procurement requirements to United States purchasing activities even if higher costs are incurred.

The purpose of this study is to reconstruct the impact of balance of payment considerations upon our logistical posture in Western Europe, 1960-1974, and to identify any changes that may be dictated to related Department of Defense policies and procedures. The findings of the study indicate that the redirection of procurements to stateside purchasing activities has substantially added to budgetary costs and has impaired supply responsiveness. Moreover, rapid growth within the commercial sector of the United States balance of payment account has appreciably reduced the significance of military overseas expenditures. These considerations have caused the author to hypothesize that the return of procurements to stateside purchasing activities is no longer justified if the domestic price exceeds the cost from foreign

sources. Rather, procurements should be made where the dual requirements of cost effectiveness and supply responsiveness are best satisfied.

The study analyzes data and information obtained from the Congressional Record, the Office of the Secretary of Defense (Comptroller), the Army and Air Force European Commands, as well as reports and studies of independent agencies. Research indicates that the impact of balance of payments considerations upon our European military forces occurred in three general phases. From 1960-1963, a series of "quick-fix" actions were taken to achieve prompt and measurable reductions in overseas spending. The period 1964-1970 was characterized by procedural refinements and emphasis upon sharing the balance of payment burden with our European Allies. Since 1971, there has been an evolution of concepts for achieving more direct supply support from the United States.

The findings of the study indicate that balance of payment considerations have increased joint financing of the NATO infrastructure, prompted common usage of facilities with our Allies, and contributed to the establishment of cooperative logistical systems. Modular construction, deferred maintenance programs, and increased procurements from American overseas distributors are other reflections of the balance of payment impact. Although not the only factor, the development of strategic redeployment capabilities has also been given impetus due to balance of payment considerations.

## ACKNOWLEDGEMENTS

The assistance of all who shared their knowledge, experience and time is acknowledged with deepest appreciation. In particular, I would like to thank Brigadier General Lawrence A. Fowler, USAF, who prompted my interest in the subject. Also, Mr. Leonard G. Campbell, Office of the Secretary of Defense (Comptroller) who furnished valuable insights and essential data. Lieutenant Colonel Billy C. Holland, USA, my senior research and thesis advisor, whose guidance and patience sustained my efforts. Most especially, I am grateful to my wife, Mary, whose encouragement and support made this endeavor possible.

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## CHAPTER I

### INTRODUCTION

#### General

The balance of payments (BOP) account reflects a record of economic transactions between individuals, firms, and government agencies of one nation with those of other nations. These transactions include payments and receipts for goods and services and various kinds of capital movements. For example, dollar flow results from tourism, sales of bonds and securities, private bank loans, foreign investment, and overseas defense expenditures. While the BOP account is commonly regarded as part of the international sector of a nation's economy, in fact, both the foreign and domestic elements of the economy are affected by each other and are to a degree interdependent. Certainly, the ability of the United States to compete in world markets is related to domestic economic conditions. For instance, inflation within a country tends to raise the price of exported goods and may thereby adversely affect the nation's trade position. Conversely, advancements in technology or the improvement of capital equipment may improve the competitive position of a country.

In situations where payments and receipts as well as capital movements remain in approximate equilibrium, a satisfactory BOP position

exists. However, when dollars flow out of the country for a sustained period, foreign countries may accumulate substantial holdings of United States currency. This concentration of U.S. money overseas may lower the value of the dollar in relation to other world currencies. Although DOD spending overseas represents a relatively small element of total United States international transactions, it does result in a capital outflow that is highly visible and of concern to the American public and their elected officials.

#### Background

After World War II, a disequilibrium emerged between the international demand for dollars and the available supply of dollars because many war ravaged countries could not earn sufficient hard currency to conduct normal economic activities. This dollar shortage was aggravated because many countries had more confidence in the dollar than in their own currencies and these economic forces resulted in a strong demand for dollars in relation to the supply. As a matter of deliberate policy, the United States incurred foreign exchange deficits and adopted other monetary practices designed to close the dollar gap. These actions included the Marshall Plan, policies intended to stimulate trade, and intentional attempts by the United States to find sources for offshore procurement.<sup>1</sup>

However, by 1959, economic conditions had changed and American gold reserves decreased to an amount equivalent to one hundred percent

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<sup>1</sup>U.S., Department of Defense, Office of the Secretary of Defense (Comptroller), Economics of Defense Spending, A Look at the Realities, July 1972, p. 67.

of our foreign obligations.<sup>2</sup> These changes were attributable to a complex interaction of factors that included the success of the United States programs for assisting in the recovery of foreign economies. The resurgent productive capacities of Western Europe and Japan made them more competitive with a United States economy that was experiencing domestic inflation and high wage scales. Since further reductions in our gold holdings were considered a potential threat to the viability of the dollar, government officials determined that remedial action was necessary. The basic reason for the reduction in our gold reserves was a continued imbalance in the U.S. BOP accounts. It was apparent that new economic policies were necessary to establish an equilibrium between BOP account receipts and payments.

In the late 1950's, defense spending entering the BOP account was equivalent to nearly one-fourth of the United States merchandise imports.<sup>3</sup> Although BOP commercial accounts consistently reflected trade surpluses, defense expenditures abroad contributed to a cumulative BOP deficit. As a result, the Department of Defense (DOD) undertook a number of actions to reduce its adverse impact on the United States BOP position. DOD sought to: 1) encourage its military and civilian personnel to purchase through United States outlets rather than on foreign economies, 2) maximize its procurement of materiel and services from United States sources, and 3) reduce its overseas staffing levels and close or consolidate bases. Since Foreign Military Sales (FMS) registered as a receipt

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<sup>2</sup>Howard S. Piquet, "The Balance of Payments Breakdown: Treating the Symptoms," Perspective in Defense Management, Winter 1972-1973, p. 61.

<sup>3</sup>U.S., Department of Defense, Economics of Defense Spending, p. iii.

in the BOP account; emphasis was shifted from direct grants to the sale of weapons, supplies, and supporting equipment. During the 1960's, agreements were negotiated with many of our North Atlantic Treaty Organization (NATO) Allies to offset some of the costs and foreign exchange burden associated with the stationing of our forces in Europe. Concepts involving strategic redeployment, dual basing, and equipment prepositioning were developed and tested to assess the feasibility of reducing our strength levels in NATO countries. Despite the efforts of DOD, countervailing economic pressures impeded actions designed to reduce the military BOP deficit. Foreign price increases, currency revaluations, and the BOP costs of the Vietnam War impeded efforts to reduce overseas expenditures. Additionally, substantial military and civil service pay increases added to disposable income that often flowed into foreign economies and thereby adversely effected the military BOP account.

Budgetary and foreign exchange costs of our force commitments to NATO as well as political and foreign policy considerations have caused continued Congressional concern with respect to the DOD contribution to the cumulative BOP deficit. This concern is evidenced by the passage of the Jackson-Nunn Amendment to the Defense Procurement Bill, Public Law 93-155, enacted 15 November 1973. This legislation is designed to mitigate the adverse impact of United States defense expenditures in Europe. The Amendment directs the President to seek payments from NATO members sufficient to offset any budgetary and BOP deficits incurred as a result of the deployment of our forces in Europe. The law requires that the United States reduce its forces by a percentage equivalent to whatever BOP cost is not offset. The Defense Procurement Bill conferees indicated their belief that;



...the principal objection of Members of both houses of Congress to the stationing of American forces in Europe has been the adverse impact on our balance of payments - an adverse impact that has been especially objectionable in view of the strength of the currencies of some of our NATO allies, the recurring weakness of the U.S. dollar in relation to some of those currencies and the large dollar holdings accumulated in West Europe. Thus we believe that a solution to the balance of payments problem will serve to place the continuing American presence in Europe on a more stable foundation. <sup>4</sup>

The passage of the Jackson-Nunn Amendment and dynamic changes in the United States and world economies suggest that it would be timely to review procedures instituted by DOD, during the early 1960's, to minimize military contributions to the United States BOP account. For example, net defense contributions to the BOP deficit averaged -\$2.9 billion per year during the period 1956-1959 and -\$3.0 billion from 1970-1973 (Table 1, page 13). In contrast to the modest change in the military BOP account, the United States had seen its average net liquidity balance deteriorate from -\$1.2 billion to -\$11.6 billion for the same periods (Table 1, page 13). The total annual value of commercial exports and imports averaged \$30.3 billion during the period 1956-1959; whereas, it had increased to \$139.8 billion for 1973, or, a 466 percent increase. <sup>5</sup>

The aforementioned statistics reflect a decrease in the significance of the military BOP deficit and it would appear that the offset provisions of the Jackson-Nunn amendment will further reduce the adverse impact of overseas military expenditures. Since most of the DOD actions initiated to reduce military BOP expenditures remain in effect, it would

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<sup>4</sup>Excerpt from a Joint Congressional Conference Report on the Defense Procurement Bill, October 13, 1973 (a photostat copy as received from Senator Henry Jackson's office), p. 2.

<sup>5</sup>Council of Economic Advisors, Economic Indicators, (Washington, D.C.: Government Printing Office, April 1974), p. 24; and U.S. Department of Defense, Economics of Defense Spending, p. 70.

be appropriate to review their efficacy in light of changed economic conditions. For example, Executive Order 11051, dated 27 September 1962, continues to direct DOD to return procurements to the United States, under specified circumstances, although domestic costs may exceed the foreign price. While statistics were maintained, during the 1960's, this procurement return procedure added in excess of \$388 million to the cost of stationing forces overseas.<sup>6</sup> Similarly, the economic implications of strategic redeployment, dual basing, and prepositioning may require reexamination. The only comprehensive economic analysis of this area was accomplished during 1963-1964 by the Institute for Defense Analyses.<sup>7</sup> This analysis is of limited contemporary value because of changes in force structure, strategic air lift capabilities, and economic conditions.

#### Statement of the Problem

Logistical support of United States military forces stationed in Europe is influenced by procedural constraints established to minimize the impact of defense spending upon the military BOP account. The problem is to identify the actual effect that BOP considerations have had upon our European military supply posture and to determine the continued validity of DOD BOP policies and procedures.

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<sup>6</sup>Procurement returns are discussed in Chapter II.

<sup>7</sup>William A. Cox, Rolf Piekarz, and Eleanor C. Thomas, "Redeployment of Troops to Reduce US Spending in Europe, An Economic Analysis," (unpublished study, Institute for Defense Analyses, Economic and Political Studies Division, September 1964).

### Scope and Objectives of the Study

Since the Jackson-Nunn Amendment is specifically directed toward the BOP implications of our NATO commitment and because of our long-term and substantial military presence within Western Europe, it is the intention of the author to restrict this study to an analysis of the impact of BOP considerations upon logistical support of our forces located in Western Europe, 1960-1974. It is entirely possible, and perhaps likely, that the findings of this study have applicability in other overseas areas and deserve separate consideration. This analysis will include a consideration of the logistical areas of supply, transportation, maintenance, base construction and contractual services while not specifically addressing military strength levels, overseas expenditures by military and civilian personnel and their dependents, nor support of nonappropriated fund activities. A consideration of the Military Assistance Program (MAP) and Foreign Military Sales will be confined to their impact upon offshore procurement and their positive and negative effect upon the military BOP account.

The purpose of this study is twofold, first, to establish an historical record of the impact of BOP considerations upon our logistical posture in Western Europe, 1960-1974, and secondly, to identify any necessary changes that may be dictated to DOD BOP policies and procedures.

### Methodology and Organisation

An analysis of the impact of BOP considerations upon our logistical support of American forces in Western Europe requires a recon-

struction or actions within the legislative and executive branches since 1960. This thesis will sequentially review these actions and their implementation by the Department of Defense and United States Armed Forces, Europe. Chronologically, there are three general periods that emerge in the adjustment of our European supply procedures to BOP considerations. From 1960 to 1963, a series of "quick-fix" actions were taken to achieve prompt and measurable BOP reductions; 1964-1970 was a period of procedural refinements with emphasis upon sharing our BOP burden with our NATO allies; while 1971 to the present has been characterized by the evolution of concepts for more direct supply support from the Continental United States (CONUS).

#### Definitions

Simply defined, the United States balance of payments is a system of accounting which shows receipts from foreign sources and payments to foreign sources. It reflects on the international strength of the dollar, the viability of international business and the relationship between international economic conditions and stability in the domestic economy.<sup>8</sup> Net liquidity balance is a record of a country's payments and receipts, to include long term capital flow. It considers both private and governmental transactions and is a measure of the equilibrium that exists within a nation's economy. It influences the exchange rate and stability of the currency. An exchange rate is the price of one currency in terms of another and the rate is determined by the market forces of demand and supply. A nation's importers create

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<sup>8</sup>U.S., Department of Commerce, U.S. Balance of Payments, (Washington: Government Printing Office, 1970), p. 5.

a demand for foreign exchange, whereas its exporters create a supply of foreign exchange. For the purposes of this dissertation, the impact of DOD overseas expenditures is similar to that of an import; whereas, the impact of FMS can be likened to an export.

The transactions that comprise the military BOP account represent the net balance between the amount spent in maintaining United States military forces overseas in comparison to receipts from military sales to foreign governments, hereafter referred to as Foreign Military Sales. Receipts include only military sales transactions accomplished by DOD as differentiated from direct purchases by foreign countries from United States commercial interests. Cash receipts include primarily: 1) sales of military items through DOD, 2) reimbursements to the United States for logistical support of foreign national defense forces, and 3) sales of services to the military forces of other nations.

Expenditures generally fall into three categories: 1) costs of maintaining U.S. forces abroad and their support, 2) Military Assistance Program, and 3) costs of defense related programs of other agencies such as the Coast Guard and Atomic Energy Commission. The costs involved in maintaining U.S. forces abroad include: expenditures by U.S. personnel and their families and by nonappropriated fund activities, foreign expenditures for construction of U.S. facilities, and payments to support the NATO Infrastructure and for contractual services to operate and maintain U.S. overseas installations and for the procurement of foreign goods to be used locally or in the United States.<sup>9</sup>

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<sup>9</sup>Walter S. Salant, and others, The United States Balance of Payments in 1968, (Washington, D.C.: The Brookings Institution, 1968), pp. 191-196; and Leonard G. Campbell, and Robert J. Shue, "Military Transactions in the U.S. Balance of Payments," Survey of Current Business, U.S., Department of Commerce Publication LII, No. 2 (February 1972), pp. 22-27.

Offset agreements refer to bilateral or multilateral arrangements designed to lessen the budgetary and BOP impact of stationing American forces in Europe. Offset agreements may take many forms to include: the assumption of support costs, actions to increase United States commercial exports to Europe, and commitments by European countries to use their dollar holdings to buy American military equipment.

Buy U.S. Here (BUSH) refers to procurement arrangements wherein our European purchasing activities buy U.S. end products and services from American overseas distributors. A minimum of 75 percent of all dollars expended must be returned to the United States. The system is designed to maximize supply responsiveness and minimize foreign exchange losses.

Strategic redeployment entails the airlift of combat and support forces in reaction to military contingency requirements. Equipment may accompany the redeploying forces or may be partially or completely prepositioned in the host area.

## CHAPTER II

### INITIATION OF THE BALANCE OF PAYMENT PROGRAM

1960-1963

#### Executive Action

As noted previously, the United States net liquidity balance averaged annual deficits of \$1.2 billion for the period 1956-1959. By 1960, American gold reserves had been depleted to an equivalent of one hundred percent of foreign obligations. As a result, on 16 November 1960, President Eisenhower made public a series of actions designed to alleviate the unfavorable United States BOP position; he directed the Department of Defense to:

- A. Reduce and thereafter limit the number of dependents abroad of military and civilian personnel to a total of not more than 200,000 at any one time, which total shall be subject to annual review by the President...and shall to the maximum extent feasible apply to dependents located in the highly industrialized countries with strong currencies....
- B. Take promptly all possible steps to reduce by a very substantial amount the expenditures from funds appropriated to the military services and for the military assistance program....
- C. Prohibit the purchase of foreign goods by the non-appropriated fund activities related to the military services, except where exceptions to the prohibition are made under the personal authorization of the Secretary or Deputy Secretary of Defense.<sup>10</sup>

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<sup>10</sup>U.S., President, 1952-1960 (Eisenhower), White House Press Release, Directive by the President Concerning Steps to be Taken with Respect to the United States Balance of Payments, 16 November 1960, pp. 8-9.

The restriction placed upon the number of dependents abroad had an immediate and severe impact upon military morale and inhibited recruitment efforts. As a result, on 6 February 1961, President Kennedy rescinded the ceiling on dependents and emphasized the need for reducing overseas logistical support expenditures while promoting Foreign Military Sales. He requested that DOD assess the feasibility of joint American and allied use of facilities. The President also supported increased procurements from United States sources despite the likelihood of some increases to budgetary costs.<sup>11</sup> Between 1960 and 1963, DOD experienced modest successes in controlling the net defense contributions to the United States BOP position (Table 1, page 13). Foreign price increases frustrated efforts to significantly reduce actual expenditures, but increased Foreign Military Sales resulted in a reduction of the net military deficit from \$2.75 billion in 1960 to \$2.30 billion in 1963.

However, the position of the United States BOP account remained unsatisfactory during the period 1960-1963 with the annual net liquidity balance averaging -\$2.9 billion. In response to these continued economic pressures, President Kennedy directed the Secretary of Defense to intensify efforts to shift defense buying to sources in the United States. He also called for the reduction of overseas headquarters staffs, the streamlining of overseas support operations, and the increase of Foreign Military Sales.<sup>12</sup>

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<sup>11</sup>U.S., President, 1960-1963, (Kennedy), U.S. Balance of Payments and the Gold Outflow from the United States: Message..., dated February 6, 1961, as contained in Hearings before a Subcommittee of the Committee on Banking and Currency on the Continuing Defects in our Balance of Payments and the Resulting Outflow of Gold, 89th Cong., 1st Sess., pp. 628-629.

<sup>12</sup>U.S., President, 1960-1963, (Kennedy), Balance of Payments: Message..., 88th Cong., 1st Sess., July 18, 1963, p. 46.



Table 1. Extracts from U.S. Balance of Trade Statistics<sup>13</sup>

(Values in Millions)				
Year	Direct Defense Expenditures	Transactions under Military Agency Sales Contracts	Military Transactions, Net	Net Liquidity Balance of United States
1960	-3,087	335	-2,753	+ 3,677
1961	-2,998	402	-2,596	- 2,252
1962	-3,105	656	-2,448	- 2,864
1963	-2,961	657	-2,304	- 2,713
1964	-2,880	747	-2,113	- 2,696
1965	-2,952	830	-2,122	- 2,478
1966	-3,764	829	-2,935	- 2,151
1967	-4,378	1,240	-3,138	- 4,683
1968	-4,535	1,392	-3,143	- 1,611
1969	-4,856	1,512	-3,344	- 6,081
1970	-4,852	1,478	-3,374	- 3,851
1971	-4,829	1,912	-2,918	-21,965
1972	-4,724	1,166	-3,558	-13,882
1973	-4,536	2,365	-2,171	- 7,789

<sup>13</sup>U.S., Department of Commerce, "U.S. Balance of Payments Developments, First Quarter 1973", Survey of Current Business, LIII, No. 6 (Washington, D.C.: Government Printing Office, June 1973), pp. 17-28 for calendar years 1960-1972. Council of Economic Advisers, Economic Indicators, pp. 24-25 for calendar year 1973.

### Dollar Flow

DOD implementation of Presidential guidance had to take into account the complex effects of quantitative adjustments in overseas military spending. The foreign exchange savings from reducing purchases in allied nations equal the decrease in foreign currency expenditures less the value of United States exports lost through the spending reduction. Since a lessening of defense spending decreases foreign exchange earnings and income of the host country, it normally lowers the imports of the host country from the United States and from third countries. The third countries in turn lower their imports from the United States. Economists have termed this dollar relationship between exports and imports the "feedback effect".<sup>14</sup> As a specific example, assume that the Department of Defense reduces its purchases from an Ally, West Germany, by \$10 million and that West Germany would have spent 80 percent of these lost foreign exchange earnings on imports - 15 percent in the United States and the remainder in the rest of the world. If all other countries behave just as West Germany, the \$10 million reduction in DOD foreign currency spending would lower U.S. exports by about \$4 million, leaving a foreign exchange savings of about \$6 million.<sup>15</sup>

While considering the complexities of dollar flow, DOD evaluated three general options to lower overseas procurement:

- 1) Bring the troops home and raise the alert status of deployable units to ensure their prompt return in an emergency.

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<sup>14</sup>U.S., Department of Defense, Office of the Secretary of Defense (Comptroller), Economics of Defense Spending, A Look at the Realities, p. 73b.

<sup>15</sup>Rolf Piekarz, "Defense Impacts on International Payments", (research paper for the Institute for Defense Analyses, Program Analyses Division), pp. 6 and 27.

- 2) Provide the ally with larger grants of equipment or supplies to compensate for the military units transferred to the United States.
- 3) "Stretch the pipeline" and draw on more domestic sources for the required goods and services.<sup>16</sup>

Each of the alternatives added to budgetary costs as well as having other implications. The purchase of additional equipment for prepositioning and an increased strategic airlift capability had both budgetary and military readiness implications. More grants of arms to allies increased costs and lessened United States control over its weapons arsenal.<sup>17</sup> Political as well as economic and logistic considerations caused DOD to place initial emphasis upon the second and third options. However, rather than direct grants of equipment and supplies, DOD sought to negotiate sales with its increasingly prosperous Western European allies. Categories reflected in paragraphs 1c and 2 of Table 2, page 16, became primary targets for reductions in overseas expenditures.

#### Buy U.S. Policy

Department of Defense policy as recently as 1960, had encouraged maximum use of foreign sources for the acquisition of supplies needed to support overseas operations. During 1952, the DOD "Offshore Procurement Program" had been implemented to create or expand foreign sources of supply near where requirements would be generated and consumed. The

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<sup>16</sup>Piekars, "Defense Impacts on International Payments", p. v.

<sup>17</sup>Ibid., pp. 5-6.

Table 2. U.S. Defense Expenditures Entering the Balance of Payments  
in Fiscal Year 1961<sup>18</sup>

Category	Million of Dollars
1. U.S. forces and their support	
a. Expenditures by U.S. military, civilians and dependents	775.2
b. Foreign Nationals	362.2
c. Procurement	
1) Major Equipment	52.9
2) Construction	170.1
3) Materials and supplies	562.9
4) Contractual services	487.5
Subtotal	<u>2,410.8</u>
2. Military Assistance Program	
a. Offshore Procurement	131.0
b. NATO Infrastructure	104.4
c. Other	76.0
Subtotal	<u>311.4</u>
3. Other agencies	<u>343.5</u>
Total Expenditures	<u><u>3,065.7</u></u>

<sup>18</sup>Salant, p. 193.

The purpose of offshore procurement was to strengthen the mobilization base of our allies while decreasing their dependence upon the United States. Under this Program, over two billion dollars had been spent by the United States for procurement from foreign sources by 1956.<sup>19</sup>

Air Force Procurement Instructions reflected typical procurement policies that prevailed until 1961:

The Under Secretary of the Air Force has directed that a maximum quantity of supplies, materials and services required to logistically support United States forces overseas be procured from indigenous sources, provided that such procurement will not result in one of the following:

- 1) Unjustifiable cost in comparison with procurement in the United States, including estimated or known transportation cost from the United States to using activity.
- 2) Delay in delivery unacceptable to the Department of the Air Force.
- 3) Serious adverse effects upon the United States economy, employment, or industrial mobilization.
- 4) Threats to the security of the United States.<sup>20</sup>

However, the continued unfavorable United States BOP position and the 16 November 1960 guidance of President Eisenhower caused a DOD reassessment of the Offshore Procurement Program. On 16 December 1960, DOD established a goal of reducing foreign purchases during calendar year 1961 by sixty-five million dollars. The implementing memorandum called for future research and development programs to be accomplished by United States firms whenever practical. In addition, it authorized that where the estimated cost of supplies and services would not exceed the cost of foreign services or supplies by more than twenty-five percent, such purchases should normally be made from United States suppliers.

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<sup>19</sup>U.S., Department of the Air Force, Information and Guidance Military Assistance Program, (Washington, D.C.: n.n., 1957), p. 18.

<sup>20</sup>U.S., Department of the Air Force, Air Force Procurement Instruction, (Washington, D.C.: n.n., 1957), paragraph 6-2001.

Exceptions were granted in this directive to permit:

- 1) Emergency purchases;
- 2) Procurements under one thousand dollars;
- 3) Procurements of subsistence so fragile or perishable that its quality at the point of consumption would be impaired or destroyed if shipped from the United States;
- 4) Procurements of supplies and services available only from foreign sources and for which there are no acceptable substitutes;
- 5) Procurements made with excess foreign currencies held by the United States Treasury to the extent such purchases avoid an adverse effect upon the United States balance of payments;
- 6) Procurements of supplies or services required to be made pursuant to a treaty or executive agreement;
- 7) Other procurements as specifically authorized by the Secretary of Defense.<sup>21</sup>

During 1961, approximately \$71.4 million worth of procurement contracts were returned to the United States at a cost of \$10.4 million. This represented a cost of about 17% more than the estimated cost if procurement had been made from foreign sources.<sup>22</sup>

Although interim guidance was furnished and progress monitored, the next major DOD milestone was not until 16 July 1962 when the Department of Defense issued a memorandum that was known as the Buy U.S. Policy.<sup>23</sup>

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<sup>21</sup>U.S. Department of Defense, Office of the Secretary of Defense, Memorandum to the Service Secretaries on Supplies and Services to be Procured Outside of the United States, December 16, 1960, as cited in William G. Girard, "DOD Prospects for Improving the U.S. Balance of Payments", (study, Industrial College of the Armed Forces, March 12, 1964), pp. 31-32.

<sup>22</sup>Statement of Assistant Secretary of Defense, Charles J. Hitch before U.S., Congress, Joint Economic Committee, Subcommittee on International Exchange and Payments, Outlook for United States Balance of Payments, Hearings, 87th Cong., 2nd Sess., December 12, 1962, pp. 5-6.

<sup>23</sup>The Buy U.S. Policy is distinguished from the Buy American Act which is a 1933 Congressional Statute that promotes the acquisition for public use of articles, materials, or supplies mined, produced or manufactured in the United States. Reference: Public Contracts (Buy American Act), Section 202, Subsection (c), appears in Title 41 of the United States Code, Section 11 (1970).

Its purpose was to improve the U.S. balance of payment position by adding impetus to the redirection of overseas military procurements to sources in the United States. The memorandum increased the allowable price differential from twenty-five to fifty percent in favor of procurement from American sources. It stipulated that DOD appropriated fund expenditures outside the United States would be restricted to:

1. Where a treaty or executive agreement existed to purchase from an indigenous source.
2. Procurement of requirements for less than \$500.
3. Procurements not to exceed \$10,000 required by compelling emergencies.
4. Perishable subsistence.
5. Those procurements determined in advance that the requirements can only be filled from indigenous sources. <sup>24</sup>

These restrictions were more stringent than heretofore and dollar cut-offs determined the command level authorized to approve exceptions. The magnitude of foreign origin procurements permitted as exceptions are reflected in Table 3, page 20.

Overseas procurements of \$500 or less were generally emergency purchases or nonrecurring requirements not readily available in the military supply system. "Other purchases under \$10,000" consisted of requirements which were satisfied from overseas sources because the domestic cost exceeded foreign prices by more than fifty percent.

Requirements which could only be filled from foreign sources included:

1. Utilities, including gas, water, electricity, steam, sewage, refuse collection and disposal;
2. Communication services;
3. Port handling and stevedoring services;
4. Maintenance and repair of and procurement of spare parts for foreign manufactured vehicles, equipment, machinery and systems;
5. Packing and crating services;

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<sup>24</sup>U.S., Department of Defense, Office of the Secretary, Memorandum on Supplies and Services for Use Outside the United States, 16 July 1962, pp. 4-5.

Table 3. Foreign Origin Procurements for Use Outside United States  
by Exceptions Permitted in July 16, 1962 Directive <sup>25</sup>  
(Fiscal Year 1963)

(Value in Millions of Dollars)	
Exception	Total
Exceptions, Total <sup>a/</sup>	423.6
Treaty or Executive Agreement	62.2
Procurements of \$500 or less	26.9
Emergency Procurements under \$10,000	1.7
Requirements can be filled only by foreign supplies or services	179.9
Cuban Crisis	.5
Other purchases under \$10,000	22.8
Excess Foreign Currencies	6.8
All other	49.7

<sup>a/</sup> New Contract Awards excluding Military Assistance Program,  
petroleum, non-appropriated funds procurement.

<sup>25</sup> Directorate for Statistical Services, Office of the Secretary  
of Defense, 19 September 1963 cited by Girard, p. 39.



6. Laundry and dry cleaning;
7. Coal handling and storage;
8. Industrial gases;
9. Transportation services. 26

The 50 % differential was a controversial innovation that was envisioned as a temporary measure.<sup>27</sup> The Honorable Robert V. Roosa, Under Secretary for Monetary Affairs, Department of the Treasury, reflected the ambivalent feelings of many when he said during Congressional testimony: "Of course it is clear to you and to me, I am sure, if the American supplier thinks that he can shoot fish in a barrel. You may tend to lose price discipline. But, the other side is that you have to use the American supplier to minimize the balance of payments drain."<sup>28</sup>

Between 1961 and 1963, this preferential allowance reduced overseas procurement by \$185 million, or 12 percent, at an annual budget cost of 30 percent.<sup>29</sup>

During 1963, the United States Air Force, Europe, initiated the first military service foreign procurement program in response to the Buy U.S. Policy. It inaugurated the BUSH (Buy U.S. Here) Program

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<sup>26</sup>Girard, pp. 39-40.

<sup>27</sup>Statement by Walter S. Salant, Brookings Institute, to U.S., Congress, Joint Economic Committee, The United States Balance of Payments: Perspectives and Policies, 1963, Hearing, 88th Cong., 1st Sess., 1963, p. 243.

<sup>28</sup>Statement by Honorable Robert V. Roosa, Under Secretary for Monetary Affairs, Department of the Treasury (responding to Representative William B. Windall's suggestion for stateside procurement by DOD) in Ibid., p. 124.

<sup>29</sup>Pickars, "Defense Impacts on International Payments", p. 10.

developed to obtain American made products for our overseas military forces. The BUSH Program seeks to take advantage of the commercial distribution systems established by overseas distributors of American products. When prices and delivery schedules are competitive, the requirement may be satisfied locally rather than referring it through supply channels to a stateside government procurement activity. The Program remains active and requires that a minimum of seventy-five percent of all dollars expended must be returned to the United States.<sup>30</sup>

#### Barter Agreements

During 1962, the Stockpile Policy Division of the Office of Emergency Preparedness coordinated with the Departments of Defense and Agriculture to establish a program to reduce foreign exchange losses by paying for offshore military procurements with agricultural commodities. Dollar contracts were converted into barter arrangements for nonstrategic materials. The program proved highly successful with barter procurements totaling approximately fifty million dollars for the period March through December 1963.<sup>31</sup>

#### Base Construction and Maintenance, 1960-1963

During July, 1962, DOD announced a plan to reduce the foreign exchange cost of overseas construction by the use of prefabricated housing supplied from the United States. Four months later, the

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<sup>30</sup>Letter, Headquarters U.S., Air Force, LGPLA, 27 December 1973, Bush Program in Europe with a Plan for BUSH Contracts Covering Europe, North Africa, and the Middle East, p. G-1.

<sup>31</sup>Girard, pp. 69-70.

Defense Department established a goal of reducing by twenty-five percent the fiscal year 1963 estimated expenditures for maintenance, repair, alteration, and minor construction of real property overseas. Whenever practical, materials and supplies were to be procured in the United States and supplied contractors as government furnished materials. Alterations and minor construction projects performed by contract were to be restricted to those urgently required for the support of the military mission.<sup>32</sup> During the early 1970's, the military received substantial adverse criticism about the condition of its facilities and particularly its barracks in Western Europe. It is reasonable to speculate that economies of the early 1960's, to include deferred maintenance, contributed to the unsatisfactory conditions reported by the American news media.

All contracts for maintenance estimated to exceed \$100,000, or repair work in the \$50,000-\$100,000 cost category, were to be approved by the Secretary of the Military Department or his designee. In addition, any requirement for repair work estimated to exceed \$100,000 would require advance approval by the Assistant Secretary of Defense (Installation and Logistics) or his designee.<sup>33</sup>

#### Base Closures and Consolidations, 1960-1963

The 16 July 1962 DOD Memorandum also provided the impetus for subsequent base closures and consolidations by prompting a comprehensive

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<sup>32</sup>Robert S. McNamara, Secretary of Defense, Statement at a Press Conference, Washington, D.C., 16 July 1962 as cited in Girard, p. 45.

<sup>33</sup>U.S., Department of Defense, Office of the Secretary of Defense, Memorandum to the Service Secretaries on Real Property Maintenance, Repair, Alteration, and Minor Construction Accomplished by Contract, 17 November 1962.

review of the requirements for each of our foreign military bases and installations. A special study group visited selected Western European countries to determine the feasibility of combined utilization of depots with our Allies. The study group also assessed the possibilities for reductions, eliminations, and consolidations of major logistical activities.<sup>34</sup> In addition, consideration was given to the transfer of United States logistic supply points and operations to countries where the foreign exchange costs were reduced or eliminated through offset agreements. During December 1962, Assistant Secretary of Defense (Comptroller) Charles Hitch reported that a reorganization of the Army logistics supply support line in Europe had released 5,000 personnel for other duties.<sup>35</sup> Planning was also initiated for the withdrawal of older weapons systems that could be compensated for by more advanced long-range systems located within the United States.<sup>36</sup>

#### Foreign Military Sales (FMS)

As this study progresses, it will note the changing relationship between the military and commercial aspects of the balance of payment account; therefore, it is appropriate to consider the impact of increased FMS upon the military BOP deficit. As economic pressures continued to

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<sup>34</sup>U.S., Department of Defense Memorandum on Supplies and Services 16 July 1962.

<sup>35</sup>Statement of Assistant Secretary of Defense, Charles J. Hitch, before U.S., Congress, Joint Economic Committee, Subcommittee on International Exchange and Payments, Outlook for United States Balance of Payments, Hearings, 87th Cong., 2nd Sess., December 12, 1962, pp. 5-6, as cited in Albert R. Pytko, "Significant Effects of the Gold Flow Problem on Department of Defense Decision Making" (report, Industrial College of the Armed Forces, March 29, 1968), pp. 67-68.

<sup>36</sup>Girard, pp. 47-48.

buffet the dollar, Congressional interest increased for our Allies to assume a greater share of the economic burden of supporting NATO. A Congressional Joint Economic Committee reviewed comparative NATO defense efforts (Table 4, page 26) with considerable misgivings.

The statistics were disturbing to American Congressmen because the United States exceeded all NATO members in the percentage of its gross national product expended for defense. Equally disturbing was the small proportion of the population under arms in many NATO countries. In the view of some Americans, the growing affluence and economic strength of many NATO members, combined with their proximity to the Soviet threat, dictated a more equitable sharing of the defense burden.

One result of the Congressional review was to increase emphasis upon the sale of military equipment to allies rather than furnishing grant aid. The principal objectives of the FMS Program were to:

- 1) promote the defensive strength of our allies consistent with our political and economic objectives; 2) promote the development of a common logistics system with our allies; and 3) offset the unfavorable United States BOP position resulting from deployments abroad.<sup>37</sup>

The FMS Program has largely succeeded in accomplishing its stated objectives. Our NATO allies, particularly West Germany, are substantially equipped with American weaponry. They have an investment in maintaining continued American support of these armaments. Table 1, page 13, reveals that military sales have been instrumental in significantly reducing net military contributions to the BOP deficit.

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<sup>37</sup> Statement by Robert C. Moot, Assistant Secretary of Defense (Comptroller), before the U.S., Congress, Joint Economic Committee, Subcommittee on International Exchange and Payments, A Review of Balance of Payments Policies, Hearings, 91st Cong., 1st Sess., 14 January 1969, p. 104.

Table 4. Comparative Defense Efforts, NATO Nations <sup>38</sup>

Country	Calendar Year 1962 GNP <sup>a/</sup> (factor, cost billions of U.S. dollars)	Calendar Year 1962 Defense Expenditures (millions of U.S. dollars)	Percent of GNP(factor cost) for Defense, 1962	Men under Arms 1962  Percent of Popula- tion	Total number (thous)
<b>European: <sup>b/</sup></b>					
Belgium	12.2	416	3.4	1.2	107
Denmark	6.3	223	3.5	1.0	47
France	56.7	4,206	7.4	2.0	921
Germany	72.1	4,094	5.7	.7	399
Greece	3.3	168	5.1	1.9	163
Italy	33.4	1,351	4.0	.7	367
Luxembourg	.46	7	1.6	1.2	2
Netherlands	11.9	596	5.0	1.2	142
Norway	4.6	191	4.2	.8	30
Portugal	2.4	211	8.8	1.4	128
Turkey	5.4	330	6.1	1.6	466
United Kingdom	69.0	5,001	7.2	.8	425
<b>Non-European:</b>					
Canada	31.0	1,646	5.3	.7	131
United States	506.7	54,452	10.7	1.5	2,704

<sup>a/</sup> GNP shown in this table is based on factor cost. This method of computation is used in NATO and gives figures significantly different from those arrived at through the method of computation normally used by U.S. economists. GNP at factor cost does not include indirect taxes but does include business subsidies. It gives a more favorable impression for European countries in that GNP shows as a smaller figure and defense expenditures as a greater percentage of GNP.

<sup>b/</sup> Iceland is not included because it does not maintain a defense force and does not contribute funds to European infrastructure.

<sup>38</sup> Department of Defense statistic as cited in U.S., Congress, Joint Economic Committee, The United States Balance of Payments, Report, 88th Cong., 2nd Sess., 1964, p. 29.

### Military Assistance Program (MAP)

It is necessary to briefly consider the effect of balance of payment considerations upon the Military Assistance Program because our European logistical support posture had remained intertwined with aspects of that Program. The Foreign Assistance Act of 1961 took cognizance of MAP contributions to the balance of payment deficit when Section 604 (a) of the Act directed that:

Funds made available under this Act may be used for procurement outside the United States only if the President determines that such procurement will not result in adverse effects upon the economy of the United States or the industrial mobilization base, with special reference to any areas of labor surplus or to the net position of the United States in its balance of payments with the rest of the world, which outweigh the economic or other advantages to the United States of less costly procurements outside the United States...<sup>39</sup>

Expenditures under MAP were separated into three groups: 1) off-shore procurement, 2) support of the NATO infrastructure and 3) other MAP activities. MAP offshore procurement was basically of three types:

- 1) Purchases of equipment in Western Europe and Japan to be supplied as grants to third countries;
- 2) The Mutual Weapons Development Program under which the United States shares the cost of defense research projects in foreign nations;
- 3) The Weapons Production Program under which the U.S. provides technical and other assistance to help NATO Allies establish defense production lines.

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<sup>39</sup>Foreign Assistance Act of 1961 (MAP/FMS) as cited in U.S., Department of Defense, Directive 2125.1, "Military Assistance Program Offshore Procurement (MAP/OSP)", January 2, 1962, p.8.

As a result of BOP considerations and guidance furnished by the Foreign Assistance Act of 1961, MAP offshore procurement was authorized only under the following conditions:

- 1) Government-to-Government cost-sharing projects under the Mutual Weapons Development Program;
- 2) Government-to-Government commitments involving cost-sharing production projects, when MAP offshore procurement is an integral part of the cost-sharing commitment;
- 3) Procurement required to support overriding foreign policy objectives as approved by the Secretary of State;
- 4) Procurement required to support overriding military logistical considerations which are important to the defense capabilities of the Free World.<sup>40</sup>

During 1961, the Military Assistance Program was authorized a 10% price differential to encourage domestic source acquisitions; this was later increased to 25% and subsequently to 50 % in December 1963. During 1963, policy guidance was revised to require that offshore procurement under MAP cost-sharing agreements be limited to the fulfillment of prior commitments.<sup>41</sup> These actions and emphasis upon FMS substantially reduced the scope of the European Military Assistance Program (Table 12, page 50).

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<sup>40</sup>U.S., Department of Defense, Directive 2125.1, paragraph IV, p. 2.

<sup>41</sup>U.S., Department of Defense, News Release 11-68, Statement Summarizing Actions by the Department of Defense Serving to Reduce the New Foreign Exchange Costs of Defense Activities During the Period FY 1961-FY 1967, January 4, 1968, pp. 18-19.



## CHAPTER III

### REFINEMENT OF THE BALANCE OF PAYMENT PROGRAM,

1964-1970

#### Executive Guidance

President Johnson continued the emphasis of his predecessors upon reducing contributions to the BOP deficit. In the area of logistical support, his 1965 Message to Congress noted that he had requested the Secretary of Defense to:

1. Shift defense buying from sources abroad to sources in the U.S.
2. Reduce the staffs in overseas headquarters
3. Streamline overseas support operations
4. Work with our defense partners to increase their offset purchases of military equipment in the U.S. <sup>42</sup>

In President Johnson's final Economic Report, he identified three strategic options considered by his Administration in its quest to achieve savings of foreign exchange in the military area. These options consisted of reducing the level of security, obtaining increased contributions of military forces from other countries, or neutralizing the foreign exchange costs of the United States military commitment. The first option was considered unacceptable. The second alternative was pursued, but due to its sensitive political implications, required a

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<sup>42</sup>U.S., President, 1963-1968 (Johnson), Review of International Balance of Payments and our Gold Position: Message..., 89th Cong., 1st.Sess., February 10, 1965 as cited in Hal H. Dunning, "Gold Flow Effects on Department of Defense Operations", (unpublished report, Industrial College of the Armed Forces, March 12, 1969), p. 6.

long-term effort. As a result, the last option was given immediate emphasis and its implementation during the period 1964-1970 will be reviewed in this Chapter.<sup>43</sup>

#### Cost Effectiveness of CONUS Procurement

During the 1960's, DOD returned a large quantity of procurements to the United States under the provisions of the 50 percent differential allowance. Approximately \$973 million in procurement returns were accomplished at a budgetary cost of \$388 million, or 40 percent (Table 5, page 31).

The \$340 million in foreign procurement avoidances for items used overseas refers to common military supply requirements. In all probability, the actual value of returned "procurements for use overseas" substantially exceeded statistics reflected in Table 5, page 31. This is true because once a reliable stateside source was established for an item, its management method changed from overseas local procurement to centralized management and procurement at national inventory control points (NICP's). After coding an item for centralized management, subsequent overseas requirements would be routinely referred to the appropriate NICP. The volume of such management changes and referral actions made it increasingly difficult to accurately identify procurement returns. As a result of this administrative problem, maintenance of procurement return figures was discontinued after fiscal year 1967.<sup>44</sup>

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<sup>43</sup>Economic Report of the President, January 1969, (Washington, D.C.: Government Printing Office, 1969), p. 143.

<sup>44</sup>Telephone conversation between the author and Mr. Herbert Kraft, Office of the Secretary of Defense (Comptroller), 13 December 1973. (Because of less complex accounting procedures, the maintenance of procurement return statistics for petroleum and construction contracts was continued beyond fiscal year 1967)

Table 5. Results of Department of Defense Procurement Return Programs<sup>45</sup>

(Values in Millions)					
Program	Initiated	Results for Period	Foreign Procure- ment Avoided	Added Budgetary Cost	Percentage Added Budgetary Cost
Procurement for use overseas	late 1960/ early 1961	FY 61- FY 67	\$340	\$ 75	23%
Procurement for use in the U.S.	mid CY 1962	FY 63- FY 67	13	4	31%
POL procurement	early CY 1965	FY 65- FY 68	330	164	50%
Construction	mid CY 1962	FY 63- FY 69	290	145	50%
			\$973	\$388	40%

<sup>45</sup> Contained in statement by Robert C. Moot before the U.S., Congress, Joint Economic Committee, Subcommittee on International Exchange and Payments, A Review of Balance of Payments Policies, Hearings, 91st Cong., 1st Sess., January 14, 1969, p. 102.

In actuality, the magnitude of all categories of procurement returns reflected in Table 5, page 31, may be understated because it is reasonable to hypothesize that the fifty percent differential discouraged some foreign competition. That is, it could be expected that foreign concerns would submit a bid only when they believed that they could still be competitive after application of the evaluation factor.<sup>46</sup>

The Petroleum Procurement Program reflected significant achievements in foreign procurement avoidance, but also indicated a high budgetary cost. It should be noted that in those cases where petroleum is procured from an American-owned international company, DOD payments are made directly to the corporate headquarters in the United States. During the 1960's, oil company representatives indicated that as low as forty cents of each dollar went into the foreign exchange accounts of other countries.<sup>47</sup> However, the current trend toward greater foreign control of oil interests is diminishing the importance of this once favorable factor.

Dependent upon circumstances, some overseas procurement remained desirable despite balance of payment considerations. Factors influencing foreign petroleum procurement include transportation, the location of refinery capacity, the desirability of multiple sources of supply, and political considerations. In addition to the factors of

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<sup>46</sup>U.S., Congress, Joint Economic Committee, A Review of Balance of Payments Policies, p. 136.

<sup>47</sup>Interview with Joseph J. Muir, OASD(IAL), Petroleum Logistics Policy Directorate, Department of Defense, September 15, 1966, as cited by James F. Warnock, in "Foreign Military Procurement and the Balance of Payments Problem", (unpublished report, Industrial College of the Armed Forces, March 1967), p. 52.

cost and availability, some procurement determinations were made based upon contracts negotiated in return for base rights.<sup>48</sup>

Another important consideration in evaluating the cost effectiveness of procurement returns is an analysis of the potential impact of the "feedback effect". Studies have indicated that for every dollar of reduction in defense spending, about sixty-cents in United States exports would be lost.<sup>49</sup> This ratio is probably too high for Western Europe because of its relatively strong economies.

However, England and some other Western European countries have to concern themselves with BOP considerations and this situation has been recently aggravated by rapidly escalating oil prices. Table 6, page 34, reflects how increases in the assumed feedback discount factor progressively reduce the net balance of payment savings realized by avoidances of foreign procurements. In effect, the reduction of the net balance of payment savings results in increased budgetary costs to achieve procurement avoidances.

If we assume a 20 percent "feed back" effect for FY 65-FY 68 petroleum procurement avoidance of \$330 million, we find the effective added budgetary cost to be 62 percent:

Foreign Procurements Affected	Assumed Feed- back/Discount %	Net Balance of Payments "Savings"	Added Budgetary Cost	Effective Added Bud- getary Cost %
\$330	20%	\$264.0	\$164	62%

<sup>48</sup> Campbell and Shue, p. 24.

<sup>49</sup> U.S., Department of Commerce, U.S. Balance of Payments, p. 73-B. (Also refer to Chapter II, "Dollar Flow" for an explanation of the "feedback effect".)

Table 6. Impact of Varying Feedback/Discount Factors<sup>50</sup>

(Values in Millions)

Foreign Procurements Affected	Assumed Feedback/ Discount %	Net Balance of Payments "Savings"	Added Budgetary Cost	Effective Added Budgetary Cost %
\$250	0%	\$250.0	\$100	40%
250	10%	225.0	100	44%
250	15%	212.5	100	47%
250	20%	200.0	100	50%
250	25%	181.5	100	53%
250	30%	175.0	100	57%
250	40%	150.0	100	67%

<sup>50</sup>Herbert H. Kraft, Jr., "The Impact of the U.S. Balance of Payments Problem on the Department of Defense," (unpublished report, Industrial College of the Armed Forces, 1970), p. 115.

Base Construction and Maintenance, 1964-1970

During the period 1964-1970, DOD made a concerted effort to assure that all construction not absolutely essential to military needs was deferred or eliminated. The foreign exchange costs of essential construction were reduced by the use of 1) United States procured materials, 2) United States government furnished material and equipment, 3) United States flag carriers, 4) prefabricated structures manufactured in the United States, and 5) competent troop labor.<sup>51</sup> As reflected in Table 5, page 31, construction procurement avoidances of \$290 million were achieved for FY 63-FY 69 at an added budgetary cost of \$145 million while disregarding the "feedback" effect. The reliability of figures indicating expenditures for military construction are marginal because of the difficulty in determining the proportion of contractor expenses incurred from domestic and foreign sources.<sup>52</sup> Often, contractor records failed to indicate the initial source of their materials and services.

In Europe, negotiations were begun for offset agreements, particularly with West Germany, whereby our Allies would rehabilitate the barracks of United States forces and thereby alleviate some of the burden of United States military construction expenditures. A system of international competitive bidding for maintenance and construction contracts, supporting the jointly financed NATO infrastructure facilities, was adopted. This made it possible for American companies to compete

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<sup>51</sup>U.S., Department of Defense, News Release 11-68, p. 17.

<sup>52</sup>U.S., Bureau of the Budget, U.S. Review Committee for Balance of Payments Statistics, The Balance of Payments Statistics of the United States: A Review and Appraisal, (Washington, D.C.: Government Printing Office, 1965), p. 194.

with firms from other participating countries.<sup>53</sup>

Offset Agreements, 1964-1970

In addition to its unilateral efforts to reduce overseas spending, the United States aggressively pursued arrangements with its European Allies to offset foreign exchange expenditures by two principal methods: cost-sharing and Foreign Military Sales(FMS). Support of the NATO Infrastructure involves joint financing by all members of the Alliance. The common funding is based on a cost-sharing formula which is approved by all countries. At the beginning of the program, only airfields and signal communications were eligible for cost-sharing. As the result of American initiatives, joint financing categories were increased to include such items as war headquarters, training installations, missile sites, pipelines, and ammunitions storage depots.<sup>54</sup> Installations established solely for the use of national forces, referred to as the National Infrastructure, remained solely a budgetary responsibility of the controlling nation. Installations established or operated for NATO international commanders, identified as Common Infrastructure, were subject to the cost-sharing formula except for site acquisition and the provision of certain utilities.<sup>55</sup>

Despite significant progress, American concern about foreign

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<sup>53</sup>Campbell and Shue, p. 23.

<sup>54</sup>U.S., Congress, House, Committee on Government Operations, An Investigation of U.S. Participation in the NATO Common Infrastructure Program, Hearings, 89th Cong., 2nd Sess., October 1966, pp. 4-5.

<sup>55</sup>NATO Information Service, Facts About the North Atlantic Treaty Organization, (Paris, n.n., 1965),



exchange costs remained and was formally expressed by Deputy Secretary of Defense Nitze at the December 1967 NATO Ministerial Meeting:

We will, therefore, continue to maintain forces in Europe for as long as they are desired. In saying this, however, I must also point out an anomaly in European attitudes which cannot persist. This is that on the one hand there should be no diminution of U.S. forces, but that on the other hand the responsibility for continuing U.S. deployments in Europe is none of Europe's affair. It is essential that deficits suffered by countries as a result of their stationing troops abroad in the common effort should be treated and solved by their allies on a cooperative basis. <sup>56</sup>

This continued American emphasis resulted in a reexamination of efforts directed toward interallied weapons collaboration. Since 1949, the NATO Allies had attempted to blend their separate efforts into a common program for developing and producing defense weapons. The first coordinated efforts at defense production were made by the Military Production and Supply Board established in November 1949 and by its successor the Defense Production Board established in December 1950. In 1952, a Production and Logistics Division was established as part of a newly created International Staff of NATO. <sup>57</sup> After 1960, the United States coordinated with the Production and Logistics Division to:

- 1) Further the practice of cooperative logistics and standardization with our allies by integrating our supply systems to the maximum extent feasible and by helping to limit proliferation of different types of ammunition.
- 2) Reduce the costs, to both our allies and ourselves, of equipping our collective forces, by avoiding unnecessary and costly duplication development programs and by realizing the economies possible from larger production runs.
- 3) Offset, at least partially, the unfavorable balance-of-

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<sup>56</sup>U.S., Department of the Treasury, Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy, (Washington, D.C.: N.N., January 1968), p. 81.

<sup>57</sup>NATO, pp. 119-120.

payments impact of our deployments abroad in the interest of collective defense. <sup>58</sup>

American and Allied efforts to realize multilateral weapons development and production programs have met with modest successes and some significant failures including the ill-fated Main Battle Tank (MBT) Program. Some standardization had been achieved, but it has more commonly been realized by single source procurement agreements rather than by multilateral production programs. The United States was able to exploit its technological leadership, the large size of its own weapons procurement program, and its superior logistic support system to expand its military equipment sales.<sup>59</sup> Foreign Military Sales totaled more than \$10 billion from 1960 through 1970, with 70 percent of that figure delivered during the 1965-1970 period. While partially offsetting our foreign exchange costs, it had the salutary effect of modernizing the forces of our Allies while measurably standardizing logistics and equipment support.<sup>60</sup> West Germany, in particular, closely integrated many aspects of its military logistics system into a cooperative effort with the United States. An offset agreement executed with West Germany provided for their use of United States supply lines, depots, and maintenance and support facilities.<sup>61</sup> The German Government agreed to the procurement of military goods and services on a scale significant in relation to the German defense effort but not necessarily at a level to

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<sup>58</sup>Statement by Robert S. McNamara, Secretary of Defense, before U.S., Congress, Joint Session of the Armed Services Committee and the Subcommittee on Department of Defense Appropriations, Fiscal Year 1968-1972 Defense Program and 1968 Defense Budget, Hearings, 90th Cong., 1st Sess., January 1967, p. 34.

<sup>59</sup>Piekarz, "Defense Impacts on International Payments", p. 18.

<sup>60</sup>Campbell and Shue, p. 26.

<sup>61</sup>Girard, p. 23.

completely offset United States military foreign exchange expenditures.<sup>62</sup>

### Logistical Implications of Strategic Redeployment

It is not within the scope of this study to evaluate the merits of forward deployment in Europe versus strategic airlift redeployment concepts. However, it is worthwhile to note the logistic and balance of payment implications of redeployment because it has remained a subject of Congressional interest since the successful "Big Lift Redeployment Exercise" of 1963. The attitude of many proponents of strategic redeployment shared the enthusiasm of Deputy Secretary of Defense Roswell Gilpatric when he announced:

This Big Lift Exercise will demonstrate our ability to project our military power far more quickly over far larger distances than has ever been the case in the past. By employing such a multibase capability, the U.S. should be able to make useful reductions in its heavy overseas military expenditures without diminishing its effective military strength or its capacity to apply that strength swiftly in support of its world-wide policy commitments.<sup>63</sup>

Critics of strategic redeployment noted potential problems of air interdiction, decimated forward airfields and depots, delayed responsiveness, impaired credibility of our will to defend Western Europe, and the high costs of developing an adequate airlift capability and

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<sup>62</sup>U.S., Congress, Combined Subcommittee of Foreign Relations and Armed Services Committees, United States Troops in Europe, Hearings, 90th Cong., 1st Sess., April 26 and May 3, 1967, as cited in Stanley M. Umstead, "Defense Aspects of the U.S. Balance of Payments Problem", (unpublished report, Industrial College of the Armed Forces, April 1, 1968), p. 64.

<sup>63</sup>Roswell Gilpatric, Speech given in Chicago, Illinois on October 19, 1963, as cited in Allan R. Scholin, "Big Lift Boon, Boondoggle or Bust", Air Force and Space Digest, December 1963, p. 35.

prepositioning equipment and supplies.<sup>64</sup> The controversy resulted in a comprehensive evaluation by the Institute for Defense Analyses who assumed a 15 to 30 day warning of impending hostilities and the requirement for redeployment of combat forces only, not service support activities. The study determined that complete prepositioning of equipment was most economical, but even with complete prepositioning it found that costs of \$2 to \$13 would be required for each \$1 curtailment of expenditures abroad. The cost to foreign exchange savings ratio depended on the military unit deployed and the time allowed for airlift.<sup>65</sup> Table 7, page 41 provides a sampling of typical units evaluated for the cost effectiveness of redeployment. Redeployment costs did not consider the implied expenses of investment in duplicate equipment due to prepositioning, the cost of providing adequate stateside facilities for exercises and maintaining ground forces at a higher state of alert.<sup>66</sup>

In addition to the high cost of redeployment, the net reduction in foreign currency spending is not equivalent to the total operating costs of the deployable unit. The prepositioning expenses to include the initial investment cost for facilities and the long-term operating costs must be considered, Table 8, page 42 provides a sampling of typical units for their potential net contribution toward reducing foreign currency spending.

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<sup>64</sup>Stefan Geisenheyner, "And How Did the Europeans Size up Big Lift," Air Force and Space Digest, December 1963, pp. 38-40; and Piekarz, "Defense Impacts on International Payments", p. 12.

<sup>65</sup>Cox, Piekarz, and Thomas, pp. 2-5.

<sup>66</sup>Ibid., pp. 10, 41, and 60.

Table 7. Cost-Effectiveness of Redeployment<sup>67</sup>

Army Unit	Cost of Complete Prepositioning & Troop Airlift Millions of Dollars		Reduction in Spending in Europe, Millions of Dollars <sup>a/</sup>	Cost Effectiveness Ratio <sup>b/</sup>	
	6 Day	21 Day		15 Day Deployment	30 Day Deployment
ROAD Armored Division (17E)	790.56	443.07	117.43	6.7	3.7
ROAD Mechanized Division (37E)	795.96	416.96	125.33	6.4	3.3
Field Artillery Battalion 10 5SP (6-345E)	23.57	12.69	3.58	6.6	3.5
Engineering Battalion Combat Army (5-35D)	26.47	11.74	4.89	5.4	2.3
Corps Signal Battalion (11-15D)	33.05	16.70	5.39	6.1	3.1
Armored Cavalry Squadron (17-55D)	42.87	23.14	6.60	6.5	3.5
Field Artillery Battalion Pershing (6-615T)	33.28	18.70	4.70	7.1	4.0

<sup>a/</sup> Reductions in expenditures and costs of prepositioning projected for a five year period.

<sup>b/</sup> A 15 to 30 day warning of impending hostilities is assumed during which U.S. forces could prepare and deploy for combat without interference. This assumption is made in order to minimize the airlift and prepositioning requirements of troops redeployed in the U.S.....

<sup>67</sup> Ibid., p. 59.

Table 8. Net Reduction in Foreign Currency Spending from Redeployment to the U.S. <sup>68</sup>

Army Unit	Reduction in Foreign Spending From Redeployment, Millions of Dollars	Foreign Expenditures for Prepositioning		Net Reduction, Millions of Dollars
		Investment in Prepositioning, Millions of Dollars <u>a/</u>	5 Year Prepositioning Costs, Millions of Dollars <u>b/</u>	
ROAD Armored Division (17E)	124.29	4.50	2.36	117.43
ROAD Mechanized Division (37E)	131.80	4.21	2.26	125.33
Field Artillery Battalion 10 5SP (6-345E)	3.78	0.13	0.07	3.58
Engineering Battalion Combat Army (5-35D)	5.11	0.16	0.06	4.89
Corps Signal Battalion (11-15D)	5.70	0.22	0.09	5.39
Armored Cavalry Squadron (17-55D)	6.92	0.21	0.11	6.60
Field Artillery Battalion Pershing (6-615T)	5.07	0.27	0.10	4.70

a/ One-time outlays for duplicate equipment, warehouse and construction.

b/ The sum over the five years of the continuing outlays for pay, subsistence, rotation, and training for the men needed to protect and maintain the equipment.

<sup>68</sup> Ibid., p.48.

Moreover, the true extent of foreign exchange savings had to consider that any reduction in our European deployments would result in a corresponding reduction in the magnitude of offset agreements. Also, there would be an adverse "feedback" impact on military sales and foreign commercial procurements from the United States. Although more recent empirical study data is unavailable, and the C5A aircraft has measurably improved our strategic airlift capability, it would appear that cost considerations remain a limiting factor in any consideration of large-scale redeployment.<sup>69</sup>

It would be a gross oversimplification to attribute strategic redeployment concepts and related force-level and weaponry stratification changes, during the 1960's, solely to balance of payment considerations. However, potential foreign exchange savings have certainly been a consideration in these areas and in decisions resulting in the phase-out of the B-47 strategic bomber elements in Europe, the missile activities in the United Kingdom, several La Crosse and 280 mm. gun battalions in Europe, and F102 interceptor squadrons in Spain.<sup>70</sup>

#### A Statistical Reassessment, 1960-1970

Between 1960 and 1970, defense expenditures increased from \$3,007 million to \$4, 851 million (Table 9, page 46). The increase was largely attributable to rising foreign prices and offshore procurement

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<sup>69</sup> An evaluation of experience data derived from redeployment exercises of the 1ST Infantry Division (Mechanized) would provide some contemporary information on this subject. The Division employs a dual basing concept with its main body at Fort Riley, Kansas, and one Brigade in West Germany. The Division conducts annual "Reforger" redeployment exercises. "It was a concept instituted in the years of the Vietnam War to conserve troop strength and to alleviate the BOP problem". Kansas City Times, March 28, 1974, p. 6B.

<sup>70</sup> Pytko, p. 68; and Umstead, pp. 53-54.

in support of the Vietnam War effort. In Europe, DOD had expended \$1,652 million in 1960 and remained below that level until 1970.

Increased prices and the 1969 Deutsche mark revaluation caused our European expenditures to total \$1,774 for 1970 (Table 10, page 47).

DOD experienced its least success in controlling expenditures by:

1) U.S. personnel, 2) military exchanges and clubs, and 3) employment of foreign citizens either through direct hire or contractual services, and 4) general contractual services.

Expenditures declined or increased at a more moderate rate in the areas of construction, support of the NATO infrastructure, procurement of materials and supplies, and the Military Assistance Program (Table 9, page 46). The value of grant aid deliveries to Europe that had averaged \$967 million during the period 1950-1963, was reduced to a yearly average of \$50 million for 1964-1970 and amounted to only \$12.8 million for 1970 (Table 11, page 49). Concurrently, Foreign Military Sales to Europe increased from a yearly average of \$120 million during the period 1950-1963 to \$579 million for 1964-1970 with sales of \$639.4 million for 1970 (Table 12, page 50). In 1960, expenditures in Europe totalled 53 percent of overseas defense expenditures versus 36 percent during 1970 (Chart 1, page 48).

Although DOD witnessed a gradual increase in its net military BOP deficit during the 1960's, the contributions of our European defense forces actually declined when both expenditures and Foreign Military Sales were considered.<sup>71</sup> Adjustments to the BOP problem in Europe,

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<sup>71</sup>Our 1960 defense expenditures of \$1,652 million in Europe were partially offset by total military sales of \$335 million, or a net military BOP deficit of \$1,317 million.

Our 1970 defense expenditures of \$1,774 million in Europe were partially offset by military sales to European Allies valued at \$639 million, or a net military BOP deficit of \$1,135 million.

Survey of Current Business, Vols 53 and 56, June 1973, pp. 24-28.



had a profound effect upon our logistical posture in the areas of supply and procurement procedures, base construction and maintenance, facilities usage, mutual weapons development and coproduction, and logistical support of our NATO allies.

Table 9. Defense Expenditures Abroad for Goods and Services,  
by Major Category 72

	(Millions of Dollars)										
	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
TOTAL	3,087	2,998	3,105	2,961	2,880	2,952	3,764	4,378	4,535	4,856	4,851
Department of Defense Expendi- tures	2,722	2,694	2,839	2,765	2,755	2,894	3,718	4,367	4,526	4,845	4,841
Expenditures by U.S. Personnel and by Military Exchanges, Clubs, ets.	806	772	829	843	954	1,050	1,256	1,391	1,499	1,651	1,833
Foreign Citizens (direct and con- tract hire)	363	388	414	429	409	422	482	558	581	652	686
Construction	166	152	110	92	106	152	353	382	272	326	261
NATO Infrastruc- ture	117	50	85	56	55	41	46	49	55	33	40
Contractual Ser- vices	466	490	522	536	570	589	754	993	1,056	1,094	1,086
Major Equipment	56	59	79	84	88	75	145	197	199	198	181
Materiels and Supplies	551	579	589	510	427	453	492	721	809	833	713
Military Assis- tance Program	197	204	211	215	146	112	90	76	55	58	41
Coast Guard and Atomic Energy Commission De- fense Expendi- tures	365	304	266	196	125	58	46	11	9	11	10

<sup>72</sup>Campbell and Shue, p. 23.

Table 10. Defense Expenditures Abroad for Goods and Services,  
by Major Country <sup>73</sup>

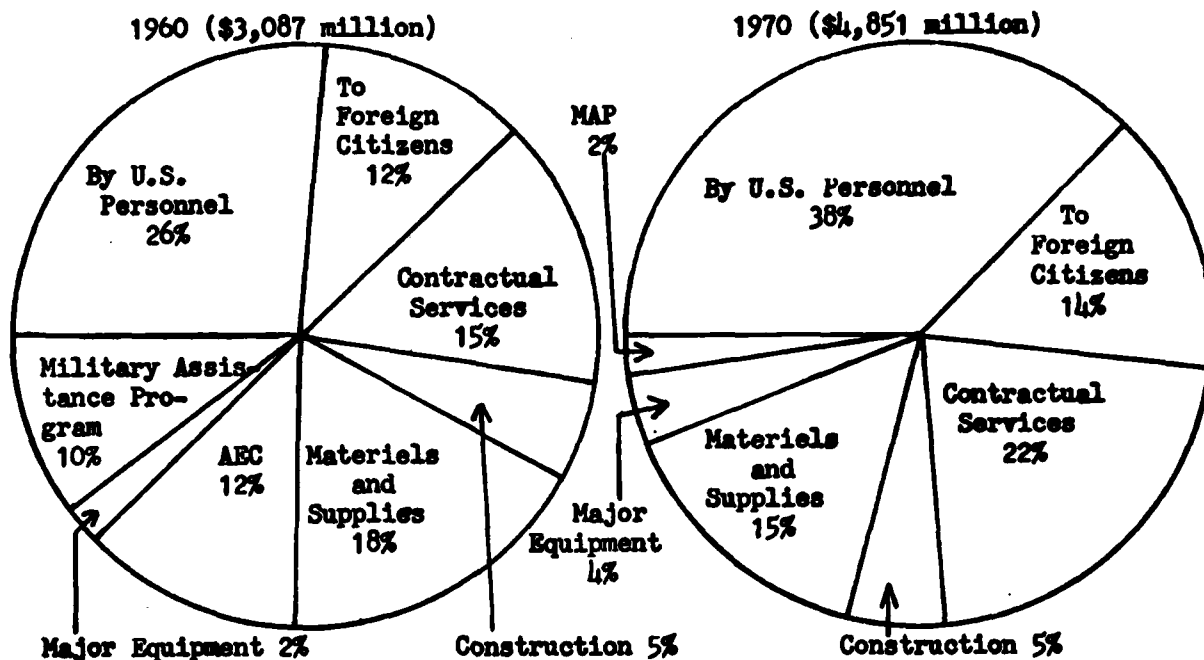
(Millions of Dollars)											
	Jan.- June 1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
TOTAL	3,087	2,998	3,105	2,961	2,880	2,952	3,764	4,378	4,535	4,856	4,851
Western Europe	1,652	1,531	1,633	1,523	1,492	1,468	1,535	1,616	1,536	1,628	1,774
Belgium/Luxem- bourg	28	12	16	12	11	12	14	35	37	39	37
Denmark/ Greenland	51	37	34	42	36	40	37	36	34	33	30
France	274	286	268	243	218	208	206	97	25	18	17
Germany	649	636	749	691	694	714	770	837	878	948	1,080
Greece	19	18	20	27	28	31	24	26	29	23	23
Iceland	14	14	12	10	11	13	17	24	18	17	21
Italy	116	97	114	93	102	106	106	102	106	122	108
Netherlands	37	28	34	31	40	41	43	49	41	44	44
Norway	17	14	15	14	24	24	28	38	32	18	8
Spain	64	54	52	49	49	45	50	48	43	47	53
Switzerland	9	6	5	8	10	11	10	12	10	12	12
Turkey	57	54	55	50	58	42	49	48	49	43	41
United Kingdom	287	225	197	184	173	154	146	210	173	208	228
Other and unallo- cated	30	50	62	69	38	31	35	54	61	56	72
Canada	387	357	326	296	258	177	205	232	285	296	253
Other Western Hemi- sphere	89	100	87	92	94	80	68	81	82	64	51
Australia, New Zea- land and South Africa	75	98	103	105	103	57	59	29	33	42	48
Other Countries	825	855	880	866	847	1,081	1,806	2,318	2,494	2,714	2,607
Bahrein	36	43	39	35	31	36	38	56	61	50	40
Japan	412	392	382	368	321	346	484	538	580	651	670
Korea	94	112	103	90	91	97	160	237	302	364	323
Morocco	26	21	18	16	7	4	5	6	6	6	7
Philippines	47	49	51	46	58	81	147	167	171	189	174
Ryuku Islands	78	93	96	97	115	123	150	188	201	229	249
Saudi Arabia	42	45	44	43	37	36	51	53	91	92	79
Taiwan	25	23	22	20	21	21	60	70	76	80	83
Thailand	5	8	30	27	34	70	183	286	318	264	226
Vietnam	7	12	37	52	64	188	408	564	556	576	527
Other and unallo- cated	53	57	58	72	68	79	120	153	132	213	229

<sup>a</sup>Includes Cambodia and Laos

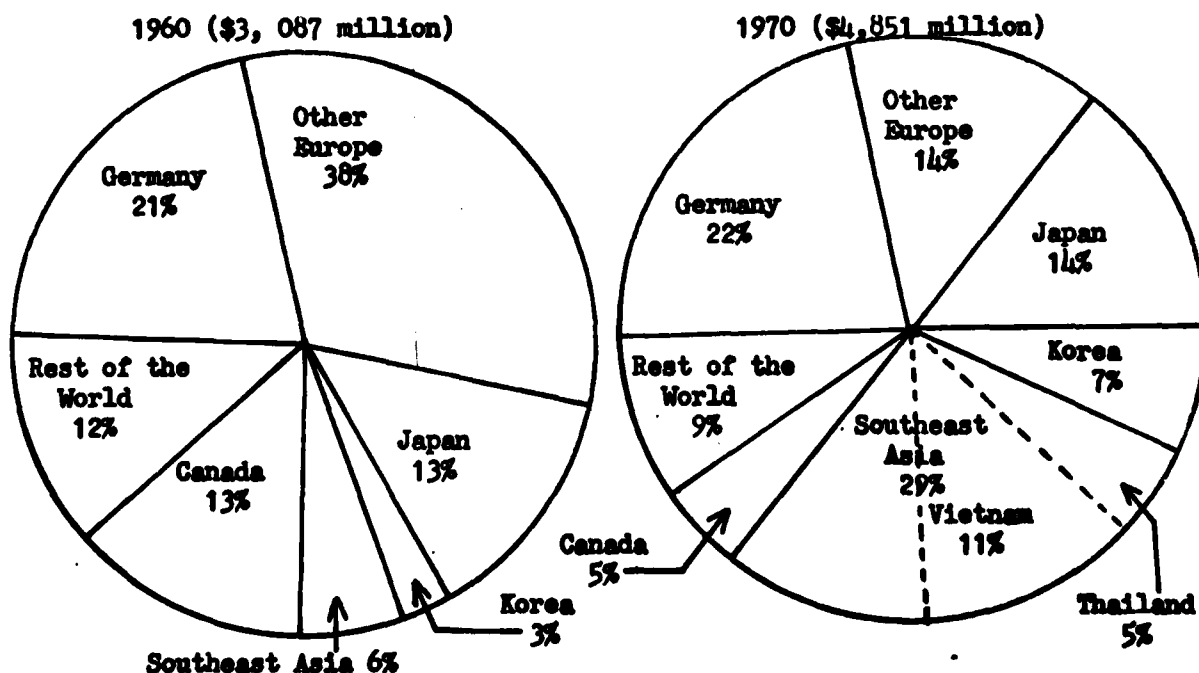
<sup>73</sup>Campbell and Shue, p. 26.

Chart 1. Distribution of Direct Defense Expenditures Abroad for Goods and Services<sup>74</sup>

BY MAJOR CATEGORIES



BY MAJOR COUNTRIES AND AREAS



<sup>74</sup>Compiled by the U.S., Department of Commerce, as cited in Campbell and Shue, p. 24.

Table 11. Military Assistance Program-Value of Grant Aid Deliveries:  
1950-1970 <sup>75</sup>

In millions of dollars. For years ending June 30. Covers programs authorized and appropriated by the Foreign Assistance Act and the Foreign Assistance Appropriation Acts. Does not include military assistance to Thailand and the other countries in Southeast Asia, which was formerly a part of this program but which has been withdrawn and put in the Department of Defense appropriation. Represents military equipment and supplies delivered and expenditures for services. Includes (a) equipment and supplies procured for the Military Assistance Program or from procurement or stocks of military departments; and (b) services such as training, military construction, repair and rehabilitation of excess stocks, supply operations, and other charges.

Area and Country	1950-1963	1964-1970	1970
Europe <sup>a/</sup>	13,542.8	703.5	12.8
Belguin	1,189.6	48.0	-
Denmark	530.0	87.9	-
France	4,144.5	8.5	-
Germany	900.4	.4	-
Italy	2,160.0	130.3	-
Luxembourg	8.2	-	-
Netherlands	1,153.7	63.3	-
Norway	701.1	187.3	.3
Portugal	293.9	24.0	1.3
Spain	436.4	141.9	10.9
United Kingdom	1,034.0	.5	-
Yugoslavia	693.9	-	-

- Represents zero.

<sup>a/</sup> Totals include countries not shown separately.

<sup>75</sup> U.S., Bureau of the Census, Statistical Abstract of the United States, 1971, Prepared under the direction of William Lerner. (Washington, D.C.: Government Printing Office, 1971), p. 244.

Table 12. Military Assistance Program-Foreign Military Sales Deliveries:  
1950-1970 <sup>76</sup>

In millions of dollars. For years ending June 30. Covers sales authorized and appropriated under the Foreign Military Sales Act. Includes deliveries of equipment, supplies, and services purchased for cash, U.S. Government financed credit, and U.S. Government guaranty of private financed credit.

Area and Country	1950-1963	1964-1970	1970
Europe <sup>a/</sup>	1,688.5	4,057.3	639.4
Belgium	53.3	61.7	7.9
Denmark	15.6	53.7	10.9
France	94.5	217.8	12.4
Germany	1,323.6	1,815.2	226.2
Italy	58.4	316.4	50.4
Netherlands	31.5	68.9	6.4
Norway	4.0	142.1	40.4
Portugal	3.7	4.2	1.1
Spain	1.1	70.9	8.6
Sweden	21.3	9.2	.5
Switzerland	12.4	91.4	43.7
United Kingdom	58.1	1,151.4	221.5
Yugoslavia	8.5	3.1	.3

<sup>a/</sup> Totals include countries not shown separately.

<sup>76</sup> Ibid., p. 244.

## CHAPTER IV

### A CHANGING LOGISTICAL POSTURE,

1971-1974

#### Adjustments in the BOP Account

On August 15, 1971, President Nixon suspended convertibility of the dollar in response to international monetary pressures. At the end of September 1971, United States liquid liabilities to all foreigners amounted to \$61 billion, or roughly three times our official reserves of \$23 billion.<sup>77</sup> In addition, the net liquidity position of the balance of payment account for 1971 deteriorated sharply to a deficit figure of \$22 billion.<sup>78</sup> For the first time since 1893, the United States had experienced a trade deficit.<sup>79</sup>

As a result, the 1972 international economic policy of the United States pursued two major objectives. First, to improve the United States balance of payment position and secondly, to make progress on reform of the international economic system as it affected monetary, trade, and investment relationships.<sup>80</sup> Unlike 1960, primary attention of

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<sup>77</sup>Thomas W.M. Smith, "The Strategic Implications of International Monetary Reform", (unpublished study, National War College, July 10, 1972), p. 1.

<sup>78</sup>U.S. Department of Commerce, "Balance of Payment Developments, First Quarter 1973", Survey of Current Business, LIII, No. 6 (June 1973), p. 24, line 33.

<sup>79</sup>"History of U.S. Balance of Payments", Congressional Quarterly Weekly Report, XXX, No. 2 (January 1, 1972), p. 18.

<sup>80</sup>U.S., President, 1968- (Nixon), Economic Report: Message..., 93rd Cong., 1st Sess., 1973, p. 113.

government economists was directed toward remedial action in the area of the commercial account rather than the military account. There were a number of reasons for this shift in emphasis to include: the deterioration of the trade balance, the effects of the 1971 dollar revaluation, changes in international capital flow and foreign investment relationships, and the lessening significance of military overseas expenditures vis a vis the total balance of payment account.

In the late 1950's, defense spending entering the balance of payment account was equivalent to nearly one-fourth of United States merchandise imports. By 1972, the proportionate relationship was reduced to less than ten percent.<sup>81</sup> The net defense impact (payments minus receipts) on our BOP account ranged from -\$2.1 billion to -\$3.6 billion between 1960 and the end of 1972.<sup>82</sup> In dollars of constant buying power, the net defense impact in FY 1972 was one third lower than the FY 1956-59 average.<sup>83</sup>

Since 1970, DOD expenditures have risen gradually in Europe with the 1971 and 1973 dollar revaluations contributing to increased support costs.<sup>84</sup> Table 13, page 54, reflects that while expenditures have risen, the net adverse balance has fluctuated due to Foreign

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<sup>81</sup>For example, the annual average for imports during the period 1956-1959 was \$13.1 billion; whereas, defense spending entering the BOP account averaged \$3.2 billion, or, a 4:1 ratio. In 1972, imports were valued at \$48.7 billion while defense spending entering the BOP account amounted to \$4.8 billion, or, a 10:1 ratio. U.S., Department of Defense, Economics of Defense Spending, p. 70.

<sup>82</sup>U.S., Department of Commerce, Survey of Current Business, 1973, p. 24, line 4.

<sup>83</sup>U.S., Department of Commerce, U.S. Balance of Payments, p. 69.

<sup>84</sup>U.S., President, 1968- (Nixon), U.S. Foreign Policy for the 1970's, Shaping a Durable Peace, (Washington, D.C.: Government Printing Office, May 3, 1973), p. 83.



Military Sales and other cash receipts. Categories experiencing the most significant dollar rise in expenditures were: 1) U.S. military and dependents, \$73 million, 2) foreign national employees, \$129 million, 3) major equipment, \$42 million, and 4) services, \$88 million. The increase in expenditures for major equipment was largely attributable to procurement agreements for the Harrier Aircraft. As a percentile increase, petroleum products were second only to major equipment.<sup>85</sup> It is reasonable to anticipate that the significance of overseas petroleum expenditures will increase as American sources diminish and foreign prices increase.

#### Procurement Actions to Lessen the Effect of Overseas Expenditures

During 1971 and thereafter, the United States Armed Forces, Europe, continued to pursue measures that would minimize the impact of military expenditures upon the BOP account. For example, the USAREUR Procurement Directorate continued to coordinate the purchase of U.S. end products and services under BUSH procedures. The use of U.S. owned excess foreign currencies and the purchase of commodities by barter arrangements were additional techniques employed to reduce exchange losses. During fiscal years 1971 through 1973, USAREUR overseas procurements increased each year; however programs such as those enumerated above lessened the BOP impact by as much as ninety-three percent.<sup>86</sup> Table 15, page 56, and Table 16, page 57, reflect the categories of expenditures and the types and dollar value of actions taken to lessen the BOP impact.

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<sup>85</sup> Refer to Table 14, page 55.

<sup>86</sup> Information furnished by the USAREUR Procurement Directorate.

Table 13. U.S. Defense Expenditures and Receipts Entering the International Balance of Payments, by NATO Country  
by Fiscal Year <sup>87</sup>

(Millions of Dollars)

European NATO	FY 1971			FY 1972			FY 1973		
	Expend- itures	Cash <sup>a/</sup> Receipts	Net Adv. Bal.	Expend- itures	Cash <sup>a/</sup> Receipts	Net Adv. Bal.	Expend- itures	Cash <sup>a/</sup> Receipts	Net Adv. Bal.
Belgium - Luxembourg	42	7	35	48	9	39	44	5	39
Denmark - Greenland	30	10	20	34	12	22	32	18	14
France	21	6	15	17	5	12	18	4	14
Germany	1178	243	935	1391	299	1092	1469	534	935
Greece	26	16	10	29	22	7	48	31	17
Iceland	22	-	22	22	-	22	24	2	22
Italy	114	48	66	125	54	71	131	53	78
Netherlands	54	13	41	56	16	40	61	37	24
Norway	9	28	+19	9	12	+3	10	21	+11
Portugal <sup>b/</sup>	9	1	8	10	2	8	10	2	8
Turkey	34	5	29	32	-	32	26	1	25
United Kingdom	232	141	91	328	143	195	125	187	138
Other NATO	44	25	19	37	24	13	45	17	28
TOTAL, European NATO	1816	543	1273	2149	598	1551	2241	912	1329

<sup>a/</sup> Cash receipts data include (1) sales of military items through the U.S. Department of Defense; (2) sales of services and excess personal property; and (3) receipts for military equipment procured through private U.S. sources where covered by government-to-government agreements, e.g., with the Federal Republic of Germany. Excludes financial arrangements, e.g., sale and redemption of medium term U.S. securities with the FRG.

<sup>b/</sup> Includes Azores.

<sup>87</sup> Statistics furnished by Mr. Leonard Campbell, OSD(C).

Table 14. U.S. Defense Expenditures Entering the International  
Balance of Payments, by NATO Country,  
by Category<sup>a/</sup> 88

	(\$ in Millions)		
	FY 1971	FY 1972	FY 1973
U.S. Military Civilians and Dependents <sup>b/</sup>	818.4	921.6	891.9
Foreign Nationals	293.5	368.1	422.1
Major Equipment	44.4	116.3	86.1
Construction	63.3	65.7	73.1
NATO Infrastructure	45.9	26.1	47.5
Petroleum, Oil, Lubricants (POL)	65.8	73.8	98.0
Materials & Supplies	105.9	115.4	125.0
Services	292.4	362.3	380.6
All other Payments (NET)	85.6	99.9	116.9
Grand TOTAL	1815.5	2148.9	2241.2

<sup>a/</sup> Excludes subcontracts in NATO countries.

<sup>b/</sup> Includes foreign expenditures by non-appropriated fund activities.

<sup>88</sup> Statistics furnished by Mr. Leonard Campbell, OSD(C).

Table 15. USAREUR Procurement by Category; Gross Obligations  
in Millions of Dollars<sup>89</sup>

Commodity	FY 71	FY 72	FY 73	FY 74 (Projected)
Subsistence	36.5	47.4	54.9	60.0
Gen Sup/Clothing & Textile Material	7.6	10.3	12.0	14.0
Office Machines	-	-	5.8	8.0
Facilities Engineering	82.4	99.5	130.2	140.0
Utilities	(39.3)	(49.7)	(57.0)	(60.0)
Repairs	(43.1)	(49.8)	(73.2)	(80.0)
Stevedoring & Transpor- tation	8.2	7.8	9.8	10.0
Packing & Containerization	-	-	4.3	5.0
Custodial & Guard Services	1.5	2.3	4.4	5.0
Education	-	-	6.7	8.0
EAM Rentals	6.9	6.1	6.0	8.0
DA Directed & MAP	13.1	5.7	8.6	10.0
Miscellaneous	15.7	20.6	6.6	7.0
Solid Fuels	31.6	39.7	27.1	30.0
Petrol Fuels & POL Storage & Handling	21.7	31.0	38.5	40.0
Construction & Architec- tural Engineering	83.6	46.7	50.5	60.0
Tank/Automotive/Missile WPN & Fire Contr Materiel (Other than DA)	28.4	33.8	37.8	40.0
Repair Parts	5.9	4.0	2.7	5.0
Ammunition	.2	.4	-	-
TOTAL	343.3	355.3	405.9	450.0

<sup>89</sup>Assimilation of statistics furnished by USAREUR Procurement Directorate.

Table 16. USAREUR Procurement Offsets<sup>90</sup>

Category	(Millions of Dollars)			
	FY 71	FY 72	FY 73	FY 74 (Proposed)
Purchase of U.S. End Products and Services	45.0	51.7	42.4	-
Barter Disbursements <sup>a/</sup>	151.6	258.0	222.9	-
Other Offsets	33.1	20.8	24.3	-
TOTAL	229.7	330.5	289.6	165.0
Percent of USAREUR Procurement Expenditures	67%	93%	70%	37%

<sup>a/</sup> Letter, HQ, USAFE LCP, subject: Offshore Procurement Program, 18 March 1974 indicates that Defense Procurement Circular 117, 18 June 1973, formally suspended the Barter Program because of the uncertainty of the agriculture commodity supply situation. However, procurements already approved by the Commodity Credit Corporation were not affected.

<sup>90</sup> Assimilation of statistics furnished by the USAREUR Procurement Directorate.

### BOP Impact upon Procurement Procedures

European supply and procurement activities have been furnished detailed guidance and procedures for authorizing offshore procurement. Some of the requirements substantially complicate the procurement process and delay the completion of supply actions. For example, the 1973 Armed Services Procurement Regulation (ASPR) establishes these provisions for award of supply and service contracts:

...If, after bid opening, or receipt of proposals or quotations, the contracting officer has knowledge that domestic cost exceeds foreign cost by more than 50% of the foreign cost, he shall:

- 1) If the domestic cost is in excess of \$10,000, forward the matter for determination;
- 2) If the domestic cost is less than \$10,000, award the contract for United States end products or services unless the differential of foreign cost is so large as to make procurement of foreign end products or services clearly desirable...<sup>91</sup>

The emphasis upon using CONUS sources of supply is illustrated by the policy statement of the Army and Air Force European Commands relative to determining sources of supply (Appendixes A&B). Prior to offshore procurement, these directives provide for testing the supply system, unless specifically excepted. They also require a certificate attesting to compliance with applicable BOP procedures and a signed individual determination and findings (IDF) or reference to the directive authorizing exemption.<sup>92</sup> Foreign source procurement determinations (FSPD) require supporting facts indicating why the requirement cannot be forgone; and why the requirement is essential to military operations; and why

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<sup>91</sup>Procedures for Supply and Service Contracts Restricted Solicitation, Paragraph 6-806.1, as cited in U.S. Department of Defense, Armed Services Procurement Regulation, 1973.

<sup>92</sup>Letter, Headquarters, U.S. Army, Europe/7A AEAGD-SM-SP, 14 September 1973, Source of Supply, with 1 enclosure.

U.S. supplies and services cannot be used (Appendix C).<sup>93</sup> Where the price differential between the U.S. end product cost and the foreign item is so great as to make the procurement of the foreign product clearly desirable, statements of fact and cost comparisons are required.<sup>94</sup>

BOP considerations have resulted in the establishment of procurement constraints that are not confined to the purchase of supplies, but consider the entire spectrum of logistical support. Appendix D reflects BOP guidelines that are applicable to procurement actions in support of: 1) construction, maintenance and repair of real property facilities, 2) the Military Assistance Program, 3) nonappropriated fund activities, and 4) cooperation with Allies in research and development of military equipment.

#### CONUS Procurement Support of Overseas Requirements

While securing authority for offshore procurement may entail considerable effort and time, it would appear that the procurement administrative lead times (PALT) of our European procurement agencies are highly competitive with CONUS purchasing activities.<sup>95</sup> For example, recent statistics indicate that the USAREUR PALT for purchases valued at less than \$2,500 normally varies from 3 to 7 days. Whereas, the Defense General Supply Center, a stateside purchasing activity for

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<sup>93</sup>USAMME Regulation 715-16, Foreign Source Procurement Determinations, page 3, paragraph 5b, 1973.

<sup>94</sup>U.S. Department of the Army, Europe, Procurement Instructions, 2 April 1973, Paragraph 1-302.72, p. 108.

<sup>95</sup>PALT is the period of time required by a procurement activity to process a purchase request from the date of its receipt to the date of its award.

general categories of supplies, experienced a PALT of approximately 40 days for purchases valued at less than \$2,500 in 1973. Procurement administrative lead time for USAREUR purchases valued in excess of \$2,500 varied from 20 to 70 days, while the PALT for the same dollar category of purchase at the Defense General Supply Center averaged 75 days during 1973.<sup>96</sup> The comparisons are an indicator but not completely valid since the items being procured are not entirely comparable.

A recent General Accounting Office Report identifies another administrative consideration related to CONUS procurement of overseas requirements. A survey conducted at the Defense General Supply Center, for the period February through May 1973, revealed a very high cancellation rate for overseas nonstock-numbered requisitions. During the four month period, there were 16,152 requisition cancellations which were equivalent to approximately 30 percent of the total receipt workload. Sixty-four percent of the cancellations were due to a lack of adequate descriptive information to permit procurement.<sup>97</sup> It is reasonable to speculate that the high cancellation rate and communications delays, impaired responsive supply support to the overseas customer. It would appear that communications between the overseas customer and his supporting procurement activity would be facilitated by their being in close proximity to one another.

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<sup>96</sup> USAREUR statistics extracted from USAREUR Procurement Instruction, 2 April 1973, Paragraph 1-2100.71, p. 125.

Defense General Supply Center statistics furnished by the Defense Supply Agency, PALT Report for FY 1973, (Alexandria, Va., n.n., 1973), pp. 169-170.

<sup>97</sup> Letter from the United States General Accounting Office, Norfolk Virginia Region, to the Commander, Defense General Supply Center, 9 July 1973, on Requisition Cancellation Causes.



Emphasis upon using CONUS as the source of supply has resulted in some problems in the areas of increased costs, decreased supply responsiveness, and impeded coordination and information exchange. However, developments in the areas of computerization, digital communications systems, automated procurement programs, and increased airlift and sealift capabilities have ameliorated many areas of concern. For example, the Defense Supply Agency has recently received military service department support for its Project J20 which features automated procurement and expedited transportation procedures to reduce supply lead times for overseas customers. The Assistant Secretary of the Air Force for Supply and Maintenance, Laurens M. Sullivan, noted that Project J20 would not only reduce overseas inventories but would also decrease overseas procurements and thereby favorably impact upon the military balance of payment account.<sup>98</sup>

Although certainly not the only consideration, the reduction of overseas procurements has been a factor in Army and Air Force efforts to streamline logistical lines of support to overseas areas. Currently, Army programs include the Direct Support Supply (DSS) System and the Commercial Construction Equipment (CCE) Program. These concepts provide for minimizing overseas stockage levels, "throughputting" supplies to user activities, and relying on commercial supply and distribution systems to the maximum extent possible.

Buy U.S. Here (BUSH) procedures continue to be used in Europe, by both the Air Force and Army. Products acquired through the BUSH

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<sup>98</sup>Letter, Department of the Air Force, Office of the Secretary of the Air Force, 16 July 1973, Support of Materiels Handling Equipment (MHE) and Commercially Designed Construction Equipment in Overseas Areas, p. 1.

Program must offer price and delivery advantages over those available from sources in CONUS. Since BUSH contracts are for American manufactured goods acquired through the several thousand United States companies and affiliates located overseas, there is a favorable impact upon our balance of payment account. Additionally, the military overseas activities are able to enjoy the benefits of: 1) local sources for spare parts and maintenance support, 2) contractor installation services for complex equipment, and 3) on-site coordination and information exchange prior to procurement.<sup>99</sup>

Contractor Operated Parts Stores (COPARS) is a system closely related to the BUSH concept and it is currently undergoing DOD level review. The procedure calls for large American equipment suppliers to maintain adequate support levels of repairables and spares in specified CONUS and overseas areas. By June 1973, more than one hundred such stores were in operation.<sup>100</sup> COPARS reflects the trend toward increased reliance upon commercial supply and distribution systems while promoting military procurement of American manufactured products. Impetus for this concept of using overseas distributors was provided by the findings of the Commission on Government Procurement. The Commission observed that the "total economic cost" of CONUS centralized procurement and

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<sup>99</sup>Frank J. Jerich, and Felix H. Jewell, "An Analysis of the DOD's Buy US Policy and It's Impact on the Local Purchase Support of Air Force Overseas Activities", (unpublished thesis, School of Systems and Logistics of the Air Force Institute of Technology, Air University, 1965), pp. 30-31 and 61.

<sup>100</sup>U.S., Department of Defense, Assistant Secretary of Defense (I&L), Memorandum on Contractor Operated Parts Stores, 14 November 1972; and Defense Supply Agency, Fact Sheet on COPARS/COCCESS in CONUS and Overseas, 15 June 1973.

supply systems had not been adequately determined by DOD and that procurements through the outlets of United States firms overseas may offer a viable alternative.<sup>101</sup>

#### Offset Agreements, 1971-1974

During the period 1971 to the present, Foreign Military Sales to Western Europe have declined to between one-quarter to one-half of the world wide total. This reduction reflects the cyclical nature of European defense procurement, the improved capabilities of European countries to develop and produce their own equipment and our increased sales to third world countries. The European countries are gradually combining their total defense requirements to increase their production base and form consortia for local industry participation which can effectively compete with United States Foreign Military Sales. However, the rising cost of labor in most European countries and the devaluation of the dollar may make our military equipment more attractive.<sup>102</sup>

In addition to the levelling off of our Foreign Military Sales in Western Europe, United States procurements of military equipment from NATO countries has risen measurably since 1971. The House Defense Appropriation Subcommittee determined that the cost of building the Harrier Aircraft in the United States was too high. As a result, DOD committed several hundred million dollars for its procurement from

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<sup>101</sup>U.S., Congress, House, Committee on Government Operations. Summary of the Report of the Commission on Government Procurement. 92nd Cong., 2nd Sess., December 1972, pp. 72-77.

<sup>102</sup>Security Assistance Program, Military Assistance Program and Foreign Military Sales, Congressional Presentation, Fiscal Year 1974, (Secret), p. 12. (These extracts are not classified.)

England with a consequent addition to the deficit of the military BOP account.<sup>103</sup> Austere DOD budgetary conditions that are likely to continue for the foreseeable future, combined with improved European technology and their emphasis upon the development of weapons designed primarily for a European battlefield scenario, may accentuate the current trend toward overseas military equipment purchases. However, there is also the possibility of negotiating additional overseas weapons purchases through bilateral or multilateral offset agreements. For example, the United States might purchase additional Harrier Aircraft while Great Britain would buy other U.S. military hardware of an equal dollar value.<sup>104</sup>

During 1973, 20 percent of the total United States weaponry exports were commercial transactions, between American manufacturers and foreign buyers, that were not credited as receipts against the military BOP account. Congress encourages such direct sales when they do not conflict with United States international interests. A comprehensive assessment of defense spending upon the United States BOP position must consider military sales and purchases made in the commercial sector of the economy.

Increased prices and wages in European countries, combined with

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<sup>103</sup>James Hessman, and Bruce Cossabom, "BOP, NATO, Harrier and a Cure for the NIH (Not Invented Here) Syndrome", Armed Forces Journal, CVIII, No. 3 (October 5, 1970), p. 22; and Campbell and Shue, p. 24.

<sup>104</sup>Hessman and Cossabom, pp. 22 and 40.

<sup>105</sup>U.S., Department of Defense, Directive 5132.3, Department of Defense Policy and Responsibilities Relating to Security Assistance ASD(ISA), 20 December 1972, paragraph III 1, page 3.

<sup>106</sup>"Global Growth in Guns", Time, CIII, No. 10 (March 11, 1974), p. 87.

the devaluation of the dollar, have resulted in DOD efforts to emphasize not only Foreign Military Sales but also other types of offset agreements. The 1971 offset agreement with West Germany provided for that country to procure more than \$1.2 billion in equipment and supplies from the United States during 1972 and 1973. A new element of that agreement was a German commitment to pursue a \$185 million program for the rehabilitation of barracks and other facilities used by United States forces in Germany.<sup>107</sup> Despite the "real offsets" of procurement and direct payments, only about one-half of the gross United States outflows on military accounts in West Germany were underwritten for 1971 through 1973 (Table 17, page 66).

Whether our NATO Allies increase their participation in offset agreements is currently uncertain. As noted previously, the provisions of the Jackson-Nunn Amendment require a reduction in our NATO force commitment commensurate with the magnitude of our military BOP deficit. An optimistic note was recently sounded by Secretary of Defense Schlesinger when he indicated the likelihood of West Germany agreeing to a \$2.4 billion, 100 percent offset, for the 1974-1975 period.<sup>108</sup> However, many Europeans still reject the idea that they should incur increased taxes to defray United States costs for defending United States interests in Europe; particularly, when they are denied equal control over our nuclear arsenal located in Europe.<sup>109</sup> In addition, if the

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<sup>107</sup>Campbell and Shue, p. 25.

<sup>108</sup>"Full U.S. Troop Strength Urged", Kansas City Times, March 29, 1974, p. 1.

<sup>109</sup>Christopher J. Allaire, "How Can We Offset the Costs of U.S. Forces in the Federal Republic of Germany", (unpublished monograph, Army War College, 1973), pp. 16 and 17; and Smith, p. 20.

Table 17. U.S. Military Deficits and Offset Agreements with West Germany,  
1968-1972<sup>110</sup>

(Millions of Dollars)					
Fiscal Year	Gross Deficit	Covered by Offset Agreements			
		Total	Financial Measures	Procurement	Direct Payments
1968	877	725	625	100	-
1969	908	725	625	100	-
1970-71 (two year)	2100	1520	925	595	-
1972-73 (two year)	2400 <sup>a/</sup>	2034	650	1200	184
1968-1973 TOTAL	6285	5004	2825	1995	184

<sup>a/</sup> Estimated; takes account of 1971 currency revaluations.

<sup>110</sup> "The Balance of Payments Mess", Hearings before the Joint Economic Committee's Subcommittee on International Exchange and Payments, June 1971 as cited in International Economic Policy Association, The United States Balance of Payments, (Washington, D.C.: International Economic Policy Association, 1972), p. 14.

perceived threat from the Soviet Union becomes less credible in Western Europe, the prospect of some decline in the American presence may prove acceptable and even desirable to our NATO Allies.<sup>111</sup>

#### Additional Offset Options

If international conditions and the provisions of the Jackson-Nunn Amendment cause our NATO Allies to accept additional economic responsibilities for our balance of payment account, it is likely that existent offset methods will be reemphasized and that new options will be considered. The purchase of United States Treasury notes by NATO Allies is a possibility, but these notes are redeemable and involve no actual costs to the buyer. Treasury notes provide temporary balance of payment relief but do not offer a long term solution acceptable to the United States. The assumption of support costs, by our NATO Allies, for our forces in Europe is considered highly desirable by the United States since it alleviates both balance of payment and budgetary concerns. However, considerations previously mentioned make it questionable whether this alternative would be palatable to our NATO Allies. Likewise, direct payments by European countries to offset the cost of our military commitments is generally unacceptable to our NATO Allies due to similar considerations. Actions to increase United States commercial exports to Europe, so as to achieve a more favorable trade balance, would provide indirect relief. It is an elusive goal that is dependent upon a myriad of factors beyond the purview of DOD. Another possibility is the selective devaluation of currency used by the United States personnel stationed

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<sup>111</sup> Allaire, pp. 16-17.

in Europe. Such a selective devaluation would reduce our foreign exchange losses.<sup>112</sup>

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<sup>112</sup>Ibid., pp. 20-24.



## CHAPTER V

### CONCLUSIONS AND RECOMMENDATION

#### General

The military balance of payment deficit has resulted in a concerted effort, by DOD, to assure that the United States and its NATO Allies equitably share both the cost and foreign exchange burden of our common defense commitment. Increased joint financing of the NATO Infrastructure and offset agreements, to include Foreign Military Sales, are indicators that these efforts have met with at least partial success. The United States remains an important supplier of military hardware to our NATO Allies; although sales have generally supplanted grants. Research, development, and coproduction efforts are now evaluated in terms of BOP implications as well as costs and military requirements. Concern about military contributions to the BOP deficit also prompted an intensive review of our logistical procedures in Europe. It would appear that this emphasis is to some degree responsible for management improvements to include the elimination of redundant supply facilities and the joint use of facilities with our NATO Allies.

#### Supply

Balance of payment considerations have had both positive and negative impacts upon our European military service supply support. The development of streamlined world-wide supply support procedures,

such as the Direct Support Supply System, have been at least partially attributable to maximum utilization of CONUS sources of supply prompted by the BOP deficit. Conversely, processing time required for the redirection of procurements to the United States, extended transportation lead time, and the problem of achieving close coordination with CONUS procurement activities have presented some difficulties.

Overseas procurement programs such as BUSH and COPARS appear to offer the dual benefits of being responsive and providing for purchases from American sources. However, for those requirements that must be procured from foreign sources, the offshore procurement procedures have been substantially complicated by BOP provisions. Administrative procedures involved in securing approval for foreign source procurement impede supply responsiveness and add to processing costs.

Emphasis upon Foreign Military Sales had resulted in not only a reduction in the net military BOP deficit, but has also contributed to the establishment of a cooperative logistics system with West Germany. Additionally, the NATO supply system has achieved a degree of standardization due to the large scale infusion of American equipment and supplies.

#### Maintenance

Available data is not sufficient to quantitatively evaluate the impact of balance of payment considerations upon the area of equipment maintenance. Maintenance and materiel readiness suffered whenever equipment had to await repair parts from CONUS sources when the same part was locally available at a reasonable cost. Although, most emergency requirements could be procured as an exception to the Buy U.S. Policy.

In some instances, the procurement and maintenance of foreign end items of equipment would most likely have been more cost effective and operationally satisfactory if balance of payment considerations had not dictated that the equipment be supplied from CONUS sources.

#### Construction and Real Property Maintenance

It is apparent that the acquisition of an increasing proportion of construction supplies from CONUS sources necessitated improved requirements planning and, in some instances, delayed the start of projects due to the nonreceipt of materials. Many desirable construction projects were delayed or deleted due to austere funding authorizations. Funds for real property maintenance were also reduced and it was not until Volunteer Army Programs were instituted, in 1971, that the general condition of facilities began to improve significantly. The inclusion of offset provisions for the rehabilitation of American barracks in West Germany were another important step in the reversal of declining real property maintenance standards.

#### Transportation

Increased reliance upon CONUS sources of supply provided an added incentive for improvements in the area of transportation support. Certainly, transportation advances such as containerization would have evolved regardless of the balance of payment situation; however, BOP considerations added value to such developments. Similarly, improvements in our strategic airlift capabilities were motivated by a myriad of considerations, but the requirement for responsive overseas logistical support was certainly an important factor.

As noted previously, an analysis of the merits of a massive strategic redeployment of our European Armed Forces extends beyond the purview of this study. Budgetary, political and combat readiness implications influence the viability of this option. However, any future assessments will undoubtedly consider balance of payment considerations such as: the termination of existing offset agreements, the "feedback effect", and the "total economic cost".

### Services

The logistical support area, like other operating elements, has continued to experience austere foreign national hiring ceilings that are attributable to both budgetary and balance of payment considerations. Other than hiring ceilings, the area of "services" was less effected than other logistical functions because most "services" represent a fairly fixed requirement such as utilities, communications, and packing and crating. As a result, efforts to control overseas expenditures in the areas of direct and indirect hiring and contractual services were comparatively unsuccessful.

### Trends

It is apparent that the military contribution to the total United States balance of payment account will continue to proportionately decline as long as threat conditions do not measurably increase. This downward trend will occur regardless of the positive or negative effect of dynamic conditions in the commercial balance of payment account, such as increasing oil imports and prices and increasing agricultural exports. Changes in the commercial sector are overshadowing the significance of

the military BOP account.

At this time, the future course of offset arrangements with our European Allies is difficult to predict with any degree of assurance. The Jackson-Nunn Amendment will require a reduction in our European force commitment commensurate with any foreign exchange costs that are not offset by our Allies. However, there is a wide-range of offset agreements that can be negotiated with our Allies, and some are more palatable than others. For example, redeemable United States Treasury Bonds would be more acceptable to our NATO Allies than would be a requirement to assume direct support costs of our forces stationed in Europe.

If recent history is a valid indicator, political as well as military and economic considerations will effect the negotiating positions of both the United States and its NATO Allies. It does appear that Western European nations will become increasingly concerned about their balance of payment positions as their requirements increase for costly mineral and energy resources. In addition, the growth of Western Europe's armaments technology and production base make it more likely that our NATO Allies will seek reciprocal, rather than unilateral, military equipment sales. Cooperation between the United States and its NATO Allies, in the area of reciprocal weapons sales, has important implications for the success of current efforts directed toward the realization of a standardized NATO supply system.

It is also appropriate to note the changing role of DOD as a contributor to the United States BOP account. The 1973 DOD net BOP deficit of \$2.2 billion was the lowest since 1965.<sup>113</sup> This favorable

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<sup>113</sup>Table 1, page 13.

position was primarily attributable to a sharp escalation in the magnitude of Foreign Military Sales. More liberal FMS provisions, current international tensions, and the increased affluence of third-world countries has caused DOD to project a two-fold increase in FMS for 1974.<sup>114</sup> An increase of these proportions would cause DOD to have a positive impact upon the U.S. BOP account as contrasted with its traditional deficit position.

#### Fifty Percent Differential

Establishment of the 50 percent differential did reduce overseas expenditures. During the period 1961 through 1967, when complete statistics were maintained, approximately \$973 million in foreign procurements were avoided at an added budgetary cost of \$388 million, or 40 percent. However, this avoidance is not particularly significant when it is realized that total defense expenditures contributing to the BOP deficit approximated \$18.5 billion for the same time period.<sup>115</sup> If we apply varying percentages of the "feedback" effect, the actual budgetary costs are as reflected by Table 18, page 75.

In addition, procedures involved in securing authority for foreign source procurement entail administrative costs as well as time. Redirection of procurements to CONUS for locally available items result in delayed supply responsiveness and problems of coordination.

Foreign exchange savings achieved by use of the 50 percent evaluation are restricted to expenditures for logistical support which

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<sup>114</sup>"Foreign Nations Clamor for U.S. Jet Fighters", Kansas City Times, 21 March 1974, pp. 1 and 14A-15A.

<sup>115</sup>Table 1, page 13.

Table 18. Impact of Varying Feedback/Discount Factors

(Values in Millions)				
Foreign Procurements Affected	Assumed Feedback/ Discount	Net Balance of Payment Savings	Added Budgetary Cost	Effective Added Budgetary Cost
\$973	20%	\$778	\$340	44%
\$973	30%	\$680	\$340	50%
\$973	40%	\$584	\$340	58%
\$973	50%	\$487	\$340	69%
\$973	60%	\$389	\$340	87%

comprise less than 40 percent of the 1972 fiscal year military expenditures of \$2.1 billion in Europe. Expenditures by military, civilians and dependents as well as the employment costs for foreign nationals accounted for more than 60 percent of our European military expenditures.<sup>116</sup> The significance of foreign exchange savings, realized by use of the 50 percent differential, is further compromised by the increasing importance of the commercial sector to the total United States Balance of Payment Account. The ratio of commercial imports to DOD overseas expenditures has widened from its 1956-1959 margin of 4:1 to its 1973 relationship of greater than 10:1. Additionally, the Jackson-Nunn Amendment will require our NATO Allies to offset any foreign exchange costs incurred by our stationing of forces in Europe, or, be confronted with withdrawals proportionate to our BOP deficit.

In view of the above considerations, it would appear prudent to consider rescission of the 50 percent differential provision at least as it applies to our commitment of forces in Western Europe. Rescission of the evaluation factor would reduce budgetary costs at a time when cost-effectiveness within the Department of Defense is a compelling requirement. Moreover, it is reasonable to postulate that our European Allies could also realize some benefits from termination of the 50 percent differential. American purchases on the local economy will increase and these procurements will be more cost-effective. As a consequence, the total support costs for United States forces will be favorably effected and the cost-sharing burden of our NATO Allies will be reduced accordingly.

It is doubtful that the magnitude of foreign source procurements

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<sup>116</sup>Table 14, page 55.



would return to pre-1960 levels. Unlike the 1950's, foreign source procurement would not be encouraged; rather, the emphasis would be directed toward supply responsiveness and cost-effectiveness. Moreover, a number of other factors would lessen the likelihood of a large increase in foreign procurements. CONUS supply and transportation systems are more responsive than during the 1950's and early 1960's. These improvements facilitate United States source acquisition for some items formerly procured overseas because of supply lead time considerations. American manufacturers have become established and cost-effective sources for many items formerly purchased overseas. The increasing presence of American distributors, in Europe, makes it more likely that they can be used as responsive sources of supply. Deutsche Mark and dollar revaluations have generally ended the era of inexpensively manufactured European products that were so attractive to our European procurement activities, during the 1950's and early 1960's. As a result of the combined effect of the aforementioned factors, a reversion to the 1960 magnitude of offshore procurements seems highly unlikely.

#### Recommendation

That the Department of Defense reassess the validity of the 50 percent differential with consideration of its impact upon logistical support procedures, its significance relative to the United States balance of payment account, and its influence upon current economic and political factors.<sup>117</sup>

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<sup>117</sup> Note: Elimination of the 50 percent differential could be accomplished incrementally by designated classes of supply or by progressive reduction of the percentile factor.

**APPENDIX**

## APPENDIX A

### BOP RESTRICTIONS - UNITED STATES ARMY EUROPE

Commanders of USAREUR Major Commands and Assigned Units and Activities  
(to Battalion Level) Heads of Staff Offices. This Headquarters.

This letter expires 1 year from date of publication.

1. This letter defines and sets forth the policy for use of the supply system and establishes the prerequisites for use of local procurement as a source of supply.
2. Items are normally required to be obtained by requisition through the supply system using the procedures established by Military Standard Request and Issue Procedures (MILSTRIP). Some items, however, may not be available through the normal supply system. Other items, although available, cannot be obtained by the required delivery date(RDU). Further some items are exempt from MILSTRIP because of blanket balance of payment (BOP) determination.
3. Once the supply officer has determined that local procurement is authorized and/or required (para 3-134h, Ar 710-2), a DA Form 14-115 or DA Form 3953 (Purchase Request and Commitment) (PR&C) will be prepared. The document number of the requisition submitted to the supply source from which local purchase authority was received will be included on the PR&C when applicable. When local procurement is authorized without prior requisitioning, the references authorizing such action will be cited. The PR&C must also indicate compliance with applicable

BOP procedures with a signed individual determination and findings (IDF) or reference to the directive authorizing exemption. A signed statement attesting to the fact that a thorough review has been conducted and the needed item cannot be related to a similar item in the Army Master Data File (AMDF) or supply catalogs will be placed in local purchase files.

4. Items manufactured in the United States and identified on the AMDF as acquisition advice code "L" or "K" require testing of the supply system before local procurement action, unless exempted in this letter or in accordance with other applicable directives. Once advice code "CP" is provided on the above items, this advice is valid until the acquisition advice code changes on the AMDF. Advice code "CP" for an item that is not listed on the AMDF is valid for 1 year or until included on the AMDF. When "CW" (one-time authorization for local purchase) is returned, the supply system must be tested before each local procurement action. Annual testing of the supply system will be accomplished for items not listed on the AMDF.

5. The requirements in this letter apply regardless of the method of local procurement used. When imprest funds are used, purchase requests will be vouchered and documented as outlined in chapter 3, AR 710-2.

6. Command inspection teams will review supply documentation to ensure compliance with criteria in this letter and other directives.

7. Inclosure 1 lists items and categories exempted from the requirement to test the supply system.

8. The policy in this letter will be included in a formal change to USAREUR Supplement 1 to AR 710-2.

1 Incl as  
14 September 1973

Department of the Army  
Headquarters, United States Army,  
Europe and Seventh Army

**Items/Categories Exempted From the Requirement to  
Test the Supply System**

1. Items in this inclosure and changes subsequently published are exempted from the requirement to test the supply system:

a. Any nonstandard item not included on the AMDF or in supply catalogs for which the extended line item value per request is less than \$100. Requirements will not be segmented to circumvent this limitation.

b. Items that are covered by annual BOP determinations and/or approved IDF are:

- |                              |   |
|------------------------------|---|
| (1) Trichlorethylene         | (12) Sand   |
| (2) Sodium chloride          | (13) Gravel   |
| (3) Hydrochloric acid        | (14) Stone  |
| (4) Rock salt                | (15) Concrete   |
| (5) Urea                     | (16) Masonry units  |
| (6) Brick dust               | (17) Fire brick   |
| (7) Road and roofing asphalt | (18) Soil   |
| (8) Lime                     | (19) Ice and dry ice  |
| (9) Whiting                  | (20) Industrial gases (except helium and propane, throwaway cylinder) |
| (10) Plaster                 |   |
| (11) Glass                   | (21) Facilities engineers engineer items (annual IDF)                 |

c. Fuel oil or other required petroleum, oils, and lubricant products not contracted for by the Defense Fuel Supply Agency (e.g., delivery of fuel oil by contractor to heating plants, quarters, and remote sights).

d. Items that are excluded from MILSTRIP:

- (1) Newspapers, magazines, periodicals, and books (including medical journals) when not available through KES or Stars and Stripes newsstands.
- (2) Music sheets and books (including band music)

- (3) Phonograph records
- (4) Driver's manuals
- (5) Maintenance manuals
- (6) Religious books, pamphlets, and curriculum material.
- (7) Rubber Stamps (except date, time, or facsimile stamps)
- (8) Postage Stamps, trophies, unit awards, and unit crests
- (9) Maps and telephone books
- (10) Drafting supplies, graphic aids, and poster materials

e. Specialized medical items to include the following:

- (1) Radioactive chemicals used for radio isotope therapy
- (2) Analyzing re-agents for diagnostic tests
- (3) Repair parts for foreign source equipment that are not available in CONUS
- (4) Orthodontic supplies
- (5) Occupational therapy supplies
- (6) Glands
- (7) Medical gases and liquid nitrogen
- (8) Medical material including standard, nonstandard expendable, and nonexpendable items determined necessary by the commander of the medical facility, provided that such local purchase is in accordance with chapter 4, AR 40-61

f. Repair parts for foreign manufactured end items (e.g. vehicles, equipment, machinery, systems), and foreign supplies because of incompatibility of US supplied items and requirements dictated by the country or geographic area (e.g. foreign documents; publications; stamps; electrical, heating, and plumbing supplies; uniforms; ceremonial items)

g. Local purchase authorization that has been received from a CONUS national inventory control point; General Services Administration; Defense Supply Agency; US Army Material Management Agency; Europe;

US Army Medical Materiel Center, Europe; or Headquarters USTASCOMEUR, as appropriate.

h. Compelling emergency purchases for the health and welfare of troops, to relieve a production stoppage of projects in motion or to satisfy a situation (e.g., fire, explosion, flood) that does not permit advance approval or the use of normal requisitioning channels, which, if not immediately corrected, could endanger life or Government property or adversely affect an essential military mission. Expenditures for compelling emergencies will not exceed \$10,000.

i. Nonappropriated Fund purchases approved by local commanders.

j. US supplies available within the command under contracts issued by US Forces.

k. Repair parts for low density, highly specialized calibration equipment, if available off shore, only after it has been ascertained that the supply system is unable to react to normally prescribed orders and ship time when calibration is required to remove other end items from deadline.

l. Local procurement authority for commercial vehicle repair parts granted to USTASCOMEUR supply support activities (SSA) for an amount not to exceed \$200 under the following conditions:

(1) Vehicle is on deadline status or parts are required to prevent production slowdown or stoppage in consolidated maintenance shops, equipment support center, general support equipment maintenance shops, or consolidated maintenance facilities

(2) Previous requisition action indicates the item will not be received within 45 days

(3) EES is given initial consideration

(4) Owing unit and USA number of the deadline vehicle requiring the item are placed on the purchase request along with the document number under which the same item was previously requisitioned

2. Exceptions to items/categories other than those in paragraph 1 will be approved/disapproved on an individual basis.



## APPENDIX B

### BOP RESTRICTIONS - U.S. AIR FORCES EUROPE<sup>118</sup>

#### Supplies/Services Not Requiring Foreign Source Procurement Determinations (FSPDs)

The following categories of supplies and services are exempt from the requirement of a formal FSPD:

a. Procurements estimated not to exceed \$500 in foreign cost. However, base procurement offices should always consolidate requirements when and where economy can result, and when it will not jeopardize meeting valid need dates of the requiring activities. In many cases, such action will involve the consolidation of requirements, each of which is under \$500 and exempt from FSPD; however, when consolidated, the requirement would exceed \$500. In these instances of consolidation, it must be determined whether or not a FSPD is required. The determination that a FSPD is not required will be made in writing, by the contracting officer and made a part of the contract file. A FSPD is required when the consolidated costs exceed \$500 for basic "like items," regardless of size, dimensions, weight, configuration, etc. The following are representative examples where FSPDs are/are not required when the consolidated cost exceeds \$500 for basic "like"/"unlike" items:

#### FSPD Required (Like Items)

Example 1: \$450 - 18" Trophies  
\$300 - 24" Trophies

Example 2: \$260 - 2 x 4 Lumber  
\$300 - 2 x 8 Lumber

Example 3: \$260 - 75 Watt Electric Bulb  
\$280 - 100 Watt Electric Bulb

**FSPD Not Required (Unlike Items)**

**Example 1:** \$475 - Steel Tubing  
\$300 - Plastic Tubing

**Example 2:** \$450 - Conduit  
\$325 - Electrical Wiring

**Example 3:** \$300 - Plywood  
\$250 - 2 x 4 Lumber

b. Procurements due to compelling emergencies estimated not to exceed \$10,000 in foreign cost. This authority will be reserved for true emergencies due to safety, health or immediate operational requirements. The contract file will be supported by a written statement from the local commander (see para 3a) explaining and fully justifying the emergency procurement. Such procurements shall be limited to the quantities of items or services essential to meet the direct needs of the emergency.

c. Procurements required to be made from indigenous sources pursuant to a treaty or executive agreement between Governments. The contract file will be clearly documented to identify the treaty or executive agreement.

d. Procurements made with excess or near-excess foreign currencies in accordance with ASPR 6-1106. Contract file documentation by the contracting officer is required.

e. Procurements of Canadian end products or domestic source end products (see ASPR 6-101) and procurements of services from Canadian or domestic concerns for use in Canada. Contract file documentation by the contracting officer is required.

f. Procurements of certain food items; specifically, bananas, tea, coffee, spices, herbs, sugar, cocoa, cream of tartar, tapioca, and coconut.

**g. Procurements of subsistence**

(1) Procurements of non-perishable commissary resale subsistence items of foreign origin for which there are no substitutes of U.S. origin and which are solely intended for resale in overseas commissary stores. The requiring activity will provide written evidence for the contract file that a substitute of U.S. origin is not available. (Troop issue non-perishable subsistence must be procured in the U.S.).

(2) Procurements of perishable commissary, fresh, chilled and frozen resale subsistence, including beef and pork.

**h. Procurements of the following requirements, provided they do not duplicate or replace existing organic service capability.**

(1) Utilities, including gas, water, electricity, steam and sewage. (AFR 26-12/USAFER 26-12 procedures are exempted for installations not having an in-house generating/processing capability for a specifically listed service; however, requiring activity will in writing, certify that in-house generating/processing capability does not exist.)

(2) Trash and refuse collection.

(3) Communications services.

(4) Port handling, stevedoring and other port charges.

(5) Maintenance and repair of, and procurement of spare parts for, foreign manufactured vehicles, equipment, machinery and systems; provided, in the case of parts, that this exception applies only if the procurement must be restricted to the original manufacturer or his supplier in accordance with ASPR 1-313. The senior official or, in his absence, the second ranking official of the requiring activity will certify, in writing, that the procurement must be restricted to the original manufacturer or his supplier, and that a U.S. substitute is not acceptable. This certification will be made a part of the contract file.

(6) Packing and crating services.

(7) Laundry and dry cleaning services.

(8) Handling and storage requirements.

(9) Industrial gases.

(10) Transportation services.

(11) Into-plane refueling.

(12) Drugs specified by the Defense Medical Material Board.

(13) The following bulk construction materials:

- (a) Sand.
- (b) Gravel.
- (c) Other soil materials.
- (d) Stone.
- (e) Concrete masonry units.
- (f) Fired brick.

(14) Overhaul and repair of vessels which are home ported overseas and which, because of their operating commitments, cannot return to the U.S. or to U.S. operated repair facilities.

(15) Terminal and maintenance services which can only be performed at overseas locations in support of aircraft flights.

(16) Custodial services.

(17) Procurement of the following requirements; provided, that foreign cost is estimated not to exceed \$10,000:

- (a) Services of part-time instructors.
- (b) Printing of base newspapers.
- (c) Dry ice.
- (d) Ready-mixed asphalt.
- (e) Portland cement concrete.

1. Procurements of other mandatory services requirements.

Recurring/routine/conventional contractual services which by their nature can only be performed locally and where an organic capability does not exist; specifically,

(1) An installation's "other mandatory requirements" for services which do not individually exceed \$100,000 in estimated foreign cost, annually or on a one-time basis, are exempted from the necessity of a formal FSPD. However, the requirements for preparation and approval of the USAFE Form 124, "Request for Use of Contract Services," must continue in effect. (See AFM 26-12/USAFER 26-12). The information reflected on USAFE Form 124 will clearly reflect that an organic capability does not exist. The local commander (see para 3a), or for USAFE command consolidation, the director of the appropriate USAFE staff agency, by indorsement to USAFE Form 124, must attest to the validity of the requirement and confirm that the required service(s) (i) cannot physically be returned to the U.S. for performance, or (ii) that it is totally impractical, non-feasible or uneconomical to have the service performed in the U.S. versus using a foreign source. This documentation will be made a part of the permanent contract file.

(2) "Other mandatory requirements" for services include, but are not necessarily limited to, billeting services; trenching/backfill services; automotive repair, engines, radiators; safe repair; railroad track maintenance; air conditioning maintenance; scale maintenance;

maintenance/cleaning exhaust fans; furniture repair; drapery/rug cleaning; printing/duplicating equipment repair; office machine maintenance/repair; cash register maintenance/repair; transformer repair; electric motor/generator repair; range/refrigerator/stove/washer/dryer repair; pump repair; uniform alteration; education services; laundry-dry cleaning services; A&E services; alarm system maintenance/repair; refrigeration equipment maintenance/repair; book binding and installation of equipment/materials.

(3) It is recognized that some other requirements for services, not listed in this paragraph, may readily fit the above described criteria of "other Mandatory requirements." In instances of this nature, contact the local procurement activity who will telephonically contact USAFE/LQPP for a case-by-case review/determination.

## APPENDIX C

### FORMAT FOR REQUEST FOR FOREIGN SOURCE PROCUREMENT <sup>119</sup>

To: Commander, US Army Materiel Management Agency, Europe, APO 09092

Subject: Foreign Source Procurement

1. Request a determination approving procurement of foreign end products or services described below:
2. A complete description (in sufficient detail to permit evaluation of the availability of US items or substitute) of the foreign end product or service contemplated for purchase.
3. The purpose for which the supplies or services are intended.
4. If applies:
  - a. The unit and quantity proposed to be purchased;
  - b. The required delivery date;
  - c. The country of origin and if a communist area, justification for the need for purchasing the product from a source in a communist area;
  - d. Cite appropriate authorization document (CTA, TA, TOE, MTOE) or inclose written authorization from competent authority.
5. If a service, Depot Maintenance
  - a. Period for which required;
  - b. The manner in which the service was previously performed, i.e., in-house or by contract. If in-house, reasons why the service must now be obtained by contract, or if a new requirement, reason why the service must be obtained by contract;
  - c. A statement as to efforts made to obtain organic capability to perform the services and results thereof;
  - d. A cost comparison of in-house versus contract cost of services.

6. If under ASPR 6-805 2 (a) (xi) unreasonable cost:
  - a. The estimated costs from the foreign source, showing as a separate cost transportation applicable to the domestic product or service;
  - b. The cubic measure or weight when packed;
  - c. A statement as to how the estimated costs were determined;
  - d. The name and address of the prospective source in the US or NICP and in the foreign country, when known.
7. A statement of the necessity for the procurement reasons why the procurement cannot be forgone and the impact upon the military operation should offshore purchase not be authorized.
8. A statement as to whether the purchase is a one-time or recurring requirement.
9. The type contract contemplated with reasons therefore.
10. A statement as to whether the procurement will be competitive or non-competitive and if non-competitive, the reasons therefore.
11. The price paid for the last previous procurement of the end product or service. The date of the last procurement, the name and address of the contractor, and, if purchased under a cost-plus-a-fixed fee (or incentive fee) contract, the amount of the fee indicated separately.
12. Why the requirement is firmly essential to military operations.

Signature of the Commander  
or his Deputy (if requirement  
exceeds \$10,000.00)

## APPENDIX D

### BOP CONSIDERATIONS - OVERSEAS PROCUREMENT

#### Construction, Maintenance and Repair of Real Property Facilities

##### Paragraph Vc

Use of these IBOP procedures may result in increased project costs. Because of the importance of reducing IBOP expenditures, these extra costs are acceptable provided the cost, over normal construction methods, does not exceed 50 percent of the amount of reduction achieved in IBOP costs. Additionally, on a case-by-case basis premium costs exceeding 50 percent may be acceptable...

U.S. Department of Defense, Directive 7060.4, 6 March 1971 with 1 change ASD (I&L), International Balance of Payments Program-Construction, Maintenance and Repair of Real Property Facilities in Foreign Countries, p. 4.

#### Military Assistance Program

##### Paragraph IV B4a

Military Assistance Program procurement of supplies and services, including construction materials (but excluding construction services) to be used outside the United States when it is estimated that the price delivered from U.S. sources will not exceed \$10,000 unless the price differential would be so large as to render this course of action clearly undesirable.

U.S. Department of Defense, Directive 2125.1, 18 June 1970 with 1 change ASD (ISA), Military Assistance Program Offshore Procurement, pp. 2-3.

##### Paragraph IV B4b

Military Assistance Programs which are estimated to exceed \$10,000 shall be restricted to domestic sources unless the cost of domestic end products or services of domestic concerns located in the United States, including packing, crating, and handling and transportation (PCH&T), is estimated to be more than 50% in excess of the cost of foreign supplies or services including PCH&T.

U.S. Department of Defense, Directive 2125.1 with 1 change, p. 3.



## Non-appropriated Fund Activities

### Paragraph V A3c

Procurement of other "not for sale" goods...will be U.S. materials and end products from domestic supplies provided the cost of U.S. goods (including transportation and handling cost) is estimated to be not more than 25% in excess of the cost of foreign goods.

U.S. Department of Defense, Directive 7060.3, 12 April 1971, ASD (M&RA), International Balance of Payments Program Non-appropriated Fund Activities, p. 7.

## Research and Development

### Paragraph IV B of Change 1

International Balance of Payments considerations have resulted in the establishment of certain specific restrictions pertinent to DOD overseas activities, including those relating to foreign R&D. The screening and selection of proposed R&D projects must be consistent with these restrictions. In this connection, preference should be given to the following types of joint R&D undertakings:

1. Projects that provide for the investment of foreign funds in the U.S. R&D activities under mutually acceptable terms and conditions.
2. Projects that offer the U.S. good prospects for the ultimate sale of the end item or associated components to second and third foreign parties.
3. Projects that capitalize on the unique technical state-of-the-art capabilities existing in a foreign country and offer prospects of saving the U.S. time and money in the R&D production field.
4. Projects that enable the U.S. to assist and/or accommodate a foreign second party to accomplish joint R&D objectives without jeopardizing U.S. aspirations to promote future U.S. sales to third countries.

U.S. Department of Defense, Directive 3100.1, 27 September 1963 with 1 change, DDR&E, Cooperation with Allies in Research and Development of Defense Equipment, p. 3.

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